ANTITRUST MODERNIZATION COMMISSION

PUBLIC HEARING

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Federal Trade Commission Headquarters, Room 432
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Washington, D.C.

The hearing convened, pursuant to notice, at 12:45 p.m.

PRESENT:

DEBORAH A. GARZA, Chairperson
JONATHAN R. YAROWSKY, Vice Chair
W. STEPHEN CANNON, Commissioner
DENNIS W. CARLTON, Commissioner
MAKAN DELRAHIM, Commissioner
JONATHAN M. JACOBSON, Commissioner
DONALD G. KEMPF, JR., Commissioner
SANFORD M. LITVACK, Commissioner
JOHN H. SHENEFIELD, Commissioner
DEBRA A. VALENTINE, Commissioner
JOHN L. WARDEN, Commissioner

ALSO PRESENT:

ANDREW J. HEIMERT, Executive Director and General Counsel
WILLIAM F. ADKINSON, JR., Counsel
TODD ANDERSON, Counsel
ALAN J. MEESE, Senior Advisor
HIRAM ANDREWS, Law Clerk
KRISTEN M. GORZELANY, Paralegal

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These proceedings were professionally transcribed by a court reporter. The transcript has been edited by AMC staff for punctuation, spelling, and clarity, and each witness has been given an opportunity to clarify or correct his/her testimony.

PROCEEDINGS

CHAIRPERSON GARZA: I'd like to welcome everyone to this afternoon's hearings on exclusionary conduct, refusals to deal, and bundling and loyalty discounts.

I'd like to welcome each of our panelists, Mr. Glazer, Mr. Popofsky, Mr. Rule, Professor Salop, and Mr. Tom.

Thank you for coming, for providing us with your written testimony, and for coming to talk to the Commissioners today.

You may already have been briefed by the staff on how this will go, but let me just review it quickly. We'll ask that each of you provide us with about a five-minute summary of your testimony. After that, we will turn to Commissioner Dennis Carlton to begin the questioning for the Commission for about 20 minutes. Following that, each of the Commissioners will have an opportunity to question the panelists.

And there are these mechanisms that you'll see here on the tables with red, yellow, and green lights that should assist you in keeping your time. I'll tell you frankly, I'm unlikely to stop anyone in the middle of their statement, so I'm going to rely on you to be self-disciplined so that we can have enough time for discussion with the Commissioners and among the panelists.

So, with that—I always tend to start at my right—Mr. Glazer, would you like to begin with your statement?

Panel I: Refusals to Deal and Bundling and Loyalty Discounts

MR. GLAZER: Thank you very much Chairperson Garza, Vice Chair Yarowsky, and Commissioners. I want to thank you for the opportunity to present my views on Section 2 of the Sherman Act.

My written testimony—the paper that I submitted—deals with three critical distinctions under Section 2 of the

Sherman Act. Given the five minutes that I have right now, I want to focus just on the third distinction: coercing versus incentivizing, which I think is the least familiar of those three distinctions.

And, just to get us oriented, this distinction applies to the area of Section 2 that I call vertical, and that is cases in which the challenged conduct involves vertical relations, dealings with customers or suppliers. For simplicity, I'll just refer to customers for the rest of this—in other words, a case in which the claim is that the defendant did something illegal to get customers to favor it over its rivals in some manner, either by giving it exclusivity, or partial or quasi exclusivity—some form of favored treatment vis-à-vis rivals. This includes cases such as *LePage's*, *R.J. Reynolds*, *Concord Boat*; predatory pricing cases, loyalty discount cases, and the like. And I use the term "vertical" to distinguish it from, of course, horizontal cases like *Aspen Skiing* and *Trinko*, which I think will be the subject of much of the testimony of other panelists today.

The basic problem with this whole vertical area is the failure to recognize that there are two fundamentally different forms of conduct at work in this area.

One is what I call coercion, and that is where the defendant refuses to deal with a customer who does business with a rival or who doesn't confer the favored treatment that the defendant is seeking. So, in other words, it's a case in which the defendant said, or allegedly said to the customer, I'm not going to sell to you at all unless you stop dealing with my rivals. The leading case is *Lorain Journal*, in which the newspaper monopolist there refused to sell advertising space to any merchant who was also going to advertise on the start-up radio station that the newspaper was trying to put out of business—or allegedly trying to put out of business.

The most recent example of that type of coercive conduct, as I view it, is the *Dentsply* case, in which the leading manufacturer of artificial teeth refused to do business with any dealers who were also buying or dealing with other tooth manufacturers.

So that's coercion, on the one hand.

On the other hand, you have incentivizing, which is very different. It's where the defendant says to the customers, I'll deal with you whether you're loyal or not. I'll sell to you in either case. You don't have to stop dealing with others. But if you're loyal, I'll give you a little better deal than I give to the others.

Courts today—and I think this is the problem with this area—courts today take a situation in which the defendant is being favored by customers, and they leap over how it got to be that way. Instead of asking how, they jump to the question of effects and foreclosure. This is wrong, because it matters very much how it got to be that way.

Now, why does it matter? Why do we care? If you have a situation in which customers have conferred exclusivity on a supplier, why do we care how it got to be that way?

There are three reasons. First, coercion is closer to the heart of Sherman 2 because it's a direct use of monopoly powers: refusal to sell a product or service that the customer needs. Incentivizing, on the other hand, does not involve the use of monopoly power at all. It involves the use of a checkbook.

Second, in the case of coercion, the customer has no choice. It's basically a take-it-or-leave-it proposition. In the incentivizing case, he does have a choice. He does not have to take the incentive. He may chose to take the incentive, in which case he'll have to go along with the conditions, but he didn't have to take the incentive.

And third, in the case of coercion, rivals have no good way of countering the coercive strategy, whereas in incentivizing they have a very good way, which is to offer their own counter-incentive.

Now, there are lots of important details involving this distinction. How do you tell coercing from incentivizing? There are some very tricky gray areas, some tough borderline cases. How do you treat the two forms of conduct? And I have some specific proposals along those lines.

But for today's purposes, to me the important point is that there is this distinction, and that it's critical. We should not treat all exclusive dealings—just to use that label, "exclusive dealing," and just tack it on to these cases and then just treat them all as if they were the same. And until we recognize this fundamental distinction, I believe this area of Section 2 is going to continue to be a muddle.

Thank you.

CHAIRPERSON GARZA: Thank you.

Mr. Popofsky?

MR. POPOFSKY: Madam Chair, and I thank the Commissioners for the opportunity to speak to you. I haven't spoken to such an august gathering since I started the argument on behalf of 3M in *LePage's*. And I was told at that time as well, I had five minutes uninterrupted. I proceeded with the proposition I thought unassailable, and that is that the case was about price. When I had finished with my pre-set speech, Chief Judge Becker said, we're not sure this is a case about price at all. And I have been at sea ever since—

[Laughter.]

–because I have a hard time—and I see everybody under the sun has a hard time—understanding *LePage's* except as a price case of some kind, at least.

Now my purpose in speaking to you today is to present the practitioner's point of view. I can't begin to run with Professor Salop, Professor Shapiro, or any of the other distinguished academicians.

But I can say this, that when one is done worrying about the economic sacrifice test, or worrying about the other kinds of economic concerns that are addressed in the tests proposed, it all has to be translated into something administrable—something that works in a trial context.

To my mind this is the point of perhaps the most important Section 2 case that was ever decided, which I think is *Barry Wright*, and does not get its adequate due, because it's Judge Breyer—as he then was—speaking about how you make operational a rule on predation.

And obviously in *Brooke Group* Judge Breyer's views prevailed. We had an operational rule—or so we thought.

I've addressed three cases in my presentation because they show that whatever the Supreme Court thought it was doing in *Brooke Group*, whatever guidance Judge Breyer was giving us in *Barry Wright*, the message does not seem to have gotten through to the lower courts. And the result is a mess.

One is the *Weyerhaeuser* case. Cert. was filed on Monday in *Weyerhaeuser*. This is a buy-side—monopsony case as opposed to sell-side. But how they differ, and how it can possibly be that paying, quote, "too much" can violate Section 2 when you can sell everything you can buy as processed lumber is quite beyond me.

On behalf of Weyerhaeuser we argued that you have to have an analogous rule that is the twin of the sell-side below-cost price rule. That was rejected in favor of a series of jury instructions, which seem to me to say to the jury, take your pick, it's David versus Goliath.

LePage's I'm sure I don't need to dwell on. And, of course, that's the heart of the bundling area, which is a topic you wish to have focused on. But *LePage's* is utterly unconnected to any analytical framework that one can possibly identify. And as proof positive of that I would submit the new *PeaceHealth* case—we filed an appellate brief in that on Friday, where the court interpreted *LePage's*—district court in Oregon—interpreted *LePage's* as saying if the little guy has less products for sale than the big guy, and the big guy sells them as a package—which a PPO, in effect, is—and therefore—and that's the operative word—cannot compete, it is illegal, or may be found to be illegal.

PeaceHealth demonstrates unequivocally that guidance is necessary. I think the Solicitor General made a horrendous mistake in *LePage's*. I don't understand my friend Professor Muris's discussion when he says that he thought on page 19, footnote 65, that the government's decision was sensible because of record deficiencies. You certainly don't get any record deficiencies on reading the opinion. And I know not what the record deficiencies were in *LePage's*.

Yet he starts out on page ten saying the rule is both mistaken and harmful to consumers, and does what I take to be a brilliant critique of the opinion.

From a practitioner's point of view, we need rules—not economic theory, but rules—something akin to the per se rule under Section 1. And I've discussed how that eroded in cases where integration was involved.

I now see—happily—the light is red.

[Laughter.]

CHAIRPERSON GARZA: And we didn't interrupt you. Thank you very much.

Mr. Rule?

MR. RULE: Thank you, Madam Chair, members of the Commission. It's an honor and a privilege to be invited to speak to you. Let me say at the outset, lest there be any doubt, that the views I've expressed in my written statement and here today are mine and mine alone, and don't represent those of any partner or client.

I hope you've had a chance to read what I've said. And I'll just summarize that quickly.

The gist of my statement is that Section 2 is a mess. In a way, I think everybody seems to agree with that. I also believe—as many, but not all, of the panelists do—that Section 2 rules should be judged and constructed with an appreciation for the costs that they impose on the economy. In other words, it's not just good enough to say there's a problem and then proceed to try to remedy it. You have to determine whether the costs of the remedy, in fact, are less than the problem to be addressed.

As I pointed out, and others had as well, there are essentially three kinds of costs that you have to be aware of with antitrust rules, and Section 2 rules: error costs, administrative costs, and uncertainty costs—the in terrorem effect of rules that aren't clear.

Second, I make the point that Section 2 really is necessary, or is available, exclusively for a very narrow set of conduct that isn't subject to other laws. Many of the things—types of conduct—that folks talk about under Section 2 actually can be reached under Section 1. And my view is that Section 1 in those cases—the rules that have developed under Section 1, which for various reasons I think are better—should probably apply, and Section 2, in those cases, is not necessary.

I certainly think the courts in *Dentsply* and *Microsoft* and other places where they found that there wasn't a violation, for example, of Section 1 or Section 3 in the case of exclusive dealing, have gone on to say that, nevertheless, they're violations of Section 2. That, to me, makes no sense.

The scope of Section 2 where only Section 2 is available—there really are kind of three areas of conduct: force or fraud; pricing and discounting; and refusals to deal. As I go through in the statement, I think, for a variety of reasons, the case for rules under Section 2 to address any of those three categories of conduct is not a very strong one—that the costs probably outweigh the benefits.

I then go on to address raising rivals' costs and profit sacrifice—although I take it that people prefer to call it the no-economic-sense rule. And, ironically, I guess, I find myself in strenuous agreement with Professor Salop, in terms of his critique of those rules—perhaps for slightly different reasons. But my sense and exposure to those rules leads me to believe that they're great generators of false positives, and not terribly effective at catching anything that you would care about.

So my bottom line is, if you were truly writing on a clean sheet of paper, you probably shouldn't write Section 2 down. I don't think you need it. And if this were a perfect world, you could probably repeal it.

On the other hand, I'm a political realist, and I recognize you can't repeal it. So at the end of my statement I make ten suggestions that a court ought to consider. I don't know how you could implement them—but ten ideas for essentially making a consumer-welfare approach under Section 2 efficient, and make the rules, in effect, generate benefits that outweigh their costs—albeit I will recognize if all ten were accepted, there wouldn't be a lot of behavior that would be caught by Section 2.

Well, my red light hasn't come on, but I'm going to stop anyway.

CHAIRPERSON GARZA: Thank you.

Professor Salop?

PROF. SALOP: Thank you, Madam Chairman. And thanks for inviting me to provide my views on monopolistic refusals to deal. I've submitted some papers. I've proposed a simplified rule, as well. But let me just introduce it here.

The rule-of-reason approach that I proposed is designed to achieve the competitive goals of the antitrust laws.

Monopolistic refusals to deal can harm competition. They can harm consumers in several ways. They can prevent entry that would erode or eliminate the monopoly. They also can limit competition markets that use the monopolist's product as an input or a complement.

I think administrable antitrust can be formulated to prevent these competitive harms, even while maintaining the innovation incentives of the monopolist. At the same time, the rules also would lead to innovation by entrants and competitors of the monopolist, so I think we would leave the economy in better competitive shape.

The legal rules that I've proposed, including the use of the benchmark, are administrable. I think they are administrable even in the less common cases in which there is no previous history of dealing.

Indeed, the price benchmark that I propose when there is no history has much in common with the profit-sacrifice/no-economic-sense test that was proposed by Doug Melamed, the DOJ, and others.

Now, there is a criticism here that it is too complex, and I readily acknowledge that properly implementing this rule-of-reason approach takes effort. It is harder to do a better job. Per se rules are obviously easier to administer.

But I think that antitrust analysis is a lot like hurricane relief. Even though it may be difficult, it is important to carry out the task directly and properly, rather than just giving up on it.

In antitrust, I think that although it's harder to do a good job, it's worth it to use the antitrust rule of reason rather than a per se rule. And I'm saddened that Mr. Popofsky has now rejected that teaching.

I do not think that per se legality would serve the interests of competition and consumer welfare, either in the long run or the short run. Moreover, I think that mandating a rule of per se legality for refusals to deal has several problematic implications for a number of antitrust policy issues.

First, a rule of per se legality for refusals to deal necessarily also would imply a rule of per se legality for tying arrangements. Refusing to sell a tied product to an unintegrated firm that wants to create its own "system," as we say in the world of complements, is analytically equivalent to refusing to sell an input that an unintegrated firm would use to compete. So there is more to this per se rule than might appear initially.

As I suggested earlier, rejecting use of a price benchmark for determining whether the refusal to deal is anticompetitive also would imply a rejection of the profit-sacrifice and no-economic-sense standards. This is because you need a benchmark for the consumer-welfare test, and that benchmark's very similar to the type of calculation that's done for profit-sacrifice. And that factor is discussed in the materials I distributed to you.

Both of them rely on estimation of costs and substitution patterns. So, at least in refusals to deal, the consumer-welfare standard and the profit-sacrifice/no-economic-sense standard converge to a great degree.

Third, if you decide to adopt an antitrust rule of per se legality for this kind of refusal to deal, it also implies in the end, I think, price regulation by expert regulatory agencies. Now, critics of my analysis say it's just too complex for generalist courts. I think this is really a defeatist attitude, and it is not a good rationale for laissez faire.

If the courts are not up to the task now, a better approach is to educate the courts or replace them with another institution that has the requisite expertise. Maybe that means assigning the cases to the FTC. But I think in our economy, it more likely would mean a formal regulatory body.

In our economy, the usual solution to monopoly—to durable monopoly power—is regulation; regulation that has typically been carried out by regulatory agencies like the FCC or FERC. The answer is not that if there's a monopoly, we should just let them alone.

As I said before, I think antitrust is up to the task of carrying out the rule-of-reason analysis, even where there is no previous history of dealing.

I also think, more generally—in terms of the work of the Commission—that what antitrust modernization should mean is making antitrust analysis more sophisticated and more economically rigorous. I think that retreating into per se rules of legality is really a poor substitute for that kind of rigorous analysis.

Thank you very much.

CHAIRPERSON GARZA: Thank you.

Mr. Tom?

MR. TOM: Thank you very much. Good afternoon, and thank you for inviting me to appear here today. It really is an honor to be here before such a distinguished group of scholars and practitioners.

You have my written testimony, and of course the disclaimers there are equally applicable to my oral remarks here.

Today I'd just like to summarize five points from that testimony.

First of all, as I think has become obvious, these are truly vexing issues. Any rules that this Commission might urge on the courts now should only be rules of thumb—particularly in the loyalty discount and bundled discount area. Our economic understanding of these practices is very much in flux, and it would be unwise, I think, to set any rules in concrete at this point.

Secondly, any rules urged on the courts now will be offered against an institutional structure of multiple enforcement, and perhaps multiple exposure to treble damages. And within that structure, false positives have an especially deleterious effect, and any rules that you recommend may be somewhat more conservative as a result. Where those features are not present, there may be a little more latitude to respond a little more quickly to new economic learning.

Third, in the loyalty discount and bundled discount area, a hypothetical, equally efficient competitor test, which by the way is equivalent to an incremental revenue versus incremental cost test—but slightly different from the *Ortho* test—has a lot to commend it. Among other things, it would be useful in counseling, because it depends on the defendants' own costs, and not that of any of its competitors.

Fourth, such a test would be in the nature of a safe harbor, because there are also other important screens, such as the existence of market power in the foreclosing market, and economies of scale in the foreclosed market. Indeed, the fact that it is not sufficient as a stand-alone test of illegality is apparent when you compare it to traditional coercive tying, harking back to Mr. Glazer's distinction, which of course, can be thought of as a zero or, indeed, negative price for the tied good— Obviously, the courts have required additional elements to be proved before declaring a tying arrangement unlawful.

Fifth, the real-world effects of such a test depend a lot on what kind of evidence is considered sufficient to satisfy it. Putting a burden on the plaintiff to demonstrate with mathematical precision incremental costs and revenues may be tantamount simply to declaring these practices per se lawful. His or her—making it an affirmative defense for which a defendant qualifies only if it is able to establish the defense with similar mathematical precision will offer no harbor at all, let alone a safe one.

This problem also brings up the issue of how we should treat intent evidence. I read Professor Shapiro's statement, and I agree with his view that intent evidence can be meaningful if it casts light on effects, and also that a generalized intent to harm competitors fails to cast any such light.

And, in that connection, one thing this Commission might consider is whether to offer some form of model jury instructions in this area and/or some guidelines to courts on what evidence is sufficient to let the case get to the jury.

Finally, let me add one caution to these points. A hypothetical if-equally-efficient-competitor test is clearly under-inclusive, and at the risk of being somewhat repetitive or too predictable, I'm going to cite Judge Posner yet again. In his very interesting article in the *University of Chicago Law Review* earlier this year he pointed out how 3M's conduct could have been anticompetitive, even if it was charging incremental prices above incremental costs on average. And in the FTC or injunctive context, it may indeed be possible to take those kinds of refinements into account. Dealing with such a possibility in the treble-damages context may be simply more than our system can afford to handle.

And with that, I will stop so that we'll have ample time for discussion.

Thank you.

CHAIRPERSON GARZA: Thank you.

Commissioner Carlton, would you like to begin your questioning?

COMMISSIONER CARLTON: Okay. Thank you.

First, I want to thank all the panelists. This is, as people have pointed out, a very difficult area, and this panel produced a very thoughtful series of statements that I think spans the spectrum from interventionist to very conservative, and therefore give us a good feel for the array of problems and possible solutions.

Let me first turn to the question of what standards to use, and whether it's appropriate to think of a standard—one standard.

On the one hand, we have the no-economic-sense test, or its close cousin, the profit-sacrifice test, and on the other hand, we have the consumer-welfare test. I was kind of reminded when I was reading through this of a sign I just saw recently when I was walking with my wife. The sign said, "There are two strategies for how you win an argument with your wife. Neither works."

[Laughter.]

Now all of these standards—

CHAIRPERSON GARZA: Was your wife carrying that sign?

[Laughter.]

COMMISSIONER CARLTON: [Laughs.] She agreed with the sign.

Now all of these tests involve a but-for standard. Okay? And what I'm worried about is exactly what that means. I'm worried that some tests that some people think are highly conservative might really not be. And let me just give you an example.

Larry, let me start with you. In your paper, you referred to, when you were criticizing *LePage's*, the fact that they didn't even investigate whether the practice resulted in a sacrifice of profits that would be irrational except for acquiring monopoly. And there are similar statements of the test: are you doing something, but for the acquisition of market power, that looks funny.

And here's what I'm worried about. There are a lot of investment activities in our economy that are short-run investments, that, if you didn't make them, you'd have more money in the short run. But presumably, in the long run, they're being used to improve a product, to advertise your product, or to make it better. Now, by you making your product better, or advertising—let's take advertising—you steal sales from your rival, you take sales from your rival. Maybe your rival goes out of business.

I'm worried that a profit-sacrifice test could lead to an investigation of, are you advertising too much? Are you improving your product too much? I mean, where does it stop?

So, I'm just trying to get—let me ask you, is that a concern you have, or do you endorse the profit-sacrifice test?

MR. POPOFSKY: I prefer it, Professor, when I'm doing the questioning and you're the witness.

[Laughter.]

As in days of yore.

Well, first of all, I do not share the view that the profit-sacrifice test is helpful. Again, I will go back to my favorite case, *Barry Wright*. Before *Barry Wright* was decided, the Ninth Circuit had attempted to identify a middle ground rule-of-reason approach between marginal cost and full cost, where you could make a judgment that the conduct was illegal even if above marginal cost. And the First Circuit, speaking through Judge Breyer, rejected that. And in *Brooke Group*, what might be termed by the administrators "limit pricing", which is another way of saying strategic pricing between those two cost pyramids, was not something that was going to trigger liability—rejected it outright.

Each of the cases that I've mentioned, *LePage's*, *Weyerhaeuser*, and *PeaceHealth*, are attempts to give a rule-of-reason kind of instruction to a jury.

I don't think you can take the profit-sacrifice test and make it operational. And indeed, that's precisely what Judge Breyer said in rejecting it.

COMMISSIONER CARLTON: Okay.

Rick? What do you think about—what I'm particularly worried about is doing the thought experiment of, assuming you don't eliminate your competitor.

MR. RULE: I give an example that, again, I think proves the point that you made, in my paper. It's probably a somewhat controversial one. It arises out of the *Microsoft* case.

But I do think there is a danger—in fact I guess I would say that the profit-sacrifice or no-economic-sense test to me is maybe the worst rule I've ever heard—with all due respect to those who promoted it. Because, first, I think it ends up overlooking or trivializing the harm to competition that I think ought to always be the center of attention, and that should be harm to competition in the sense of restricting output, not simply harming a competitor. But I think the way it's been formulated trivializes that effect.

Second, it then in effect puts a burden—and it's not so much that it's a problem at court, although I think that is true, as I'll explain, but I think it's generally that you have to advise clients that they're going to have a burden of explaining why they have done this conduct. And as you point out—and at least it's been my experience—most business-people, all they're thinking about is, it's going to get me sales; it's going to generate sales, and that means, frankly, I'm going to take sales away from somebody else; that's why I do it.

So a lot of the contemporaneous evidence, unless it's manufactured by lawyers—and I guess it's good if you create another opportunity for us to be paid to manufacture evidence at the time for clients—but leaving aside that benefit, I think that most of what gets generated contemporaneously is easily rejected at court. And then, whenever the defendant comes in to explain his or her or its conduct, it tends to get rejected as being self-serving and post hoc rationalization. And I've seen it sort of over and over and over again. I'll give a good example.

If you look at, for example, *Dentsply*, the government prevailed in that case. What *Dentsply* I think said, and what seems to me to be a reasonable argument—and I should say I had nothing to do with that case, and I haven't studied the record, although I've seen the briefs—they helped, I think, establish those various labs that they had exclusives with. They created an asset that they made an investment in, and then those labs were promoting and selling their teeth.

One could understand that, having made that investment, having established that good will and that credibility, you don't particularly want that asset to go around and, in effect, engage in opportunistic behavior by giving away or selling your goodwill to some other competitor who may have crummy teeth and that sort of thing.

And so it's reasonable to have exclusive dealing. Exclusive dealing is prevalent throughout the economy—in situations that make no sense in terms of market power or restriction of output. So you have to kind of assume that there must be some efficiency-generating potential for it.

But nevertheless, in that case both the government and the court just kind of rejected it out of hand, saying, well, you want to keep competitors away from your lab, so that's exclusionary. And it's only free-riding, and it's a sort of a back-of-the-hand to free-riding that's always—everybody always raises free-riding, and we're really not going to give it any credence.

So the result is, I think, when you have a profit-sacrifice or no-economic-sense test, I think the defendant almost always loses if you get to that point. And I think Judge Easterbrook's been a very clear proponent of this view for decades, which is: courts and juries are terrible at recognizing efficiency defenses. And if a defendant is required to defend its conduct on the basis of an efficiency defense, it's going to lose.

COMMISSIONER CARLTON: All right. Thanks.

Steve, I'd like to ask you a few questions. In your submission—

PROF. SALOP: I don't get to answer that one? That was—

[Laughter.]

COMMISSIONER CARLTON: I'm sure you will.

[Laughter.]

In your submission—your paper—you point out that a lot of vertical theories—harm from Section 2 violations—completely fail if you believe in the single monopoly price; that is the Chicago line developed initially by Aaron Director that if you're a monopolist of an input basically, you can extract that profit. And how you do it is up to you, and there's only one profit.

And then on page three you go through a number of conditions that are required for that to hold. And some of these are more—although I think I know the answer—it's going to be clarifying questions.

If you don't satisfy all those conditions that you give on page three, isn't it correct to say that the single monopoly price theory may fail—not that it does fail, but that it may fail? That's just a yes or no.

[Laughter.]

PROF. SALOP: I thought it was generally "would fail."

COMMISSIONER CARLTON: Well, okay—let me ask this: isn't it the case that it's ambiguous whether or not it fails? It's going to depend. It's going to depend on a lot of assumptions of the model, and sometimes consumer surplus could go up; sometimes it could go down. You're getting rid of double marginalization in a lot of these cases, so it's—

PROF. SALOP: I need to ask you a clarification question.

COMMISSIONER CARLTON: Okay.

PROF. SALOP: The single monopoly profit theory as we know it is a theory based on a set of several assumptions.

COMMISSIONER CARLTON: Right.

PROF. SALOP: And it shows that there's no effect on welfare. And so for you to say welfare could go up or down, well then you are already just assuming that the single monopoly profit theory doesn’t hold.

COMMISSIONER CARLTON: Yes, that was my question. Maybe I wasn’t clear.

I’m saying, suppose I grant you that the conditions don’t hold. I grant that. That doesn’t mean the theory fails. All it means is—that doesn’t mean consumer welfare will go down. It means it’s ambiguous.

PROF. SALOP: Right. It means you can’t rely on this single, one-liner that says, we don’t need to think about it because there’s only one monopoly profit.

COMMISSIONER CARLTON: It could go up, could go down.

PROF. SALOP: And therefore that’s why you need a consumer-welfare test, not simply a bunch of economists testing out the structural assumptions of a single monopoly profit theory.

COMMISSIONER CARLTON: Now, one of the conditions you list—or examples you give—is that some of these vertical theories could allow you to price discriminate. And under price discrimination welfare could go up or it could go down.

PROF. SALOP: Mm-hmm.

COMMISSIONER CARLTON: Does that mean that you would want to use the antitrust laws to prevent price discrimination in which you came to a determination that consumer welfare went down?

PROF. SALOP: Are you talking about refusals to deal, or antitrust generally?

COMMISSIONER CARLTON: I'm just talking about refusals to deal.

PROF. SALOP: Okay. And so the price discrimination would be the discrimination against the competitor.

COMMISSIONER CARLTON: Well, just a simple example: suppose that I'm vertically integrated, and I sell output A. You're someone who sells output B. And I want to charge you one price that you then pass on to your consumers of B, and I want to charge my consumers of A another price.

PROF. SALOP: Mm-hmm.

COMMISSIONER CARLTON: And I don't want to let you produce A. And I say, you can't produce A. If you produce A, I'm not going to sell you B, because I want to engage in price discrimination. The traditional *Alcoa* example of vertical integration.

PROF. SALOP: Mm-hmm.

COMMISSIONER CARLTON: So my question is—we know refusals of dealing can allow that—Is it your position that you would find that actionable under the antitrust laws if you determine consumer welfare went down?

PROF. SALOP: Well, I think you have got a very simple hypothetical that leaves out a number of important elements. First of all, if you deal with this firm, they may end up entering the market over which you have a monopoly.

They would use it as a toehold—

COMMISSIONER CARLTON: Yes.

PROF. SALOP: —to eliminate the famous two-level entry problem.

Now, I believe that everyone would agree that refusing to deal under those circumstances would be anticompetitive.

COMMISSIONER CARLTON: Yes, but you've just established that you become the competitor of A—I mean the input.

I'm asking a much simpler question: pure price discrimination.

PROF. SALOP: Well, you're assuming away—

COMMISSIONER CARLTON: I'm—

PROF. SALOP: —if you assume away the potential competitive harms, then I would agree there's no competitive harms.

COMMISSIONER CARLTON: Ah-hah. But that means then that consumer welfare isn't the dominating criteria in determining antitrust liability. That was my point, that your paper, as written, indicates you would be opposed to price discrimination even though there's no effect on competition.

PROF. SALOP: I think that the antitrust laws, to some extent, privilege pricing, and one must take that constraint into account.

But to the extent that the way in which the refusal to deal works is that it reduces competition in the market, then I think the plaintiff should have a right to prove consumers are harmed.

COMMISSIONER CARLTON: So since we know that most vertical issues involve a combination of price discrimination—first you get to charge people different prices—and perhaps have an effect on competition, you're going to have to weigh those two things. And that's going to be a difficult calculation. That's my point.

I mean, would you agree with that?

PROF. SALOP: Yes, I think you should—I think you need to take into account those sorts of constraints. But—

COMMISSIONER CARLTON: Okay.

PROF. SALOP: I think the consumer—I think that you're actually—you know, the conditions under which this hypothetical would apply are very, very narrow.

If the monopolist in your model faces the threat of entry, or if there would be more competition in the downstream market or in a market for complements, then there would be consumer harms. And I think the normal room we give to the monopolist to set the prices that he wants would not carry through.

COMMISSIONER CARLTON: Would you require a firm to supply an input to a rival downstream, even if that firm never made any outside sales of the input?

PROF. SALOP: Potentially, yes—subject to my standard. I don't give a free pass to people that have never dealt with outsiders before. And, indeed, if you give out that free pass, you're less likely to have firms dealing to begin with.

COMMISSIONER CARLTON: Okay, let me turn to Mr. Glazer. And, again, this is on the but-for standard, which is imbedded in your distinction between incentivizing and coercing.

In order to decide whether you're incentivizing, you compare it to the but-for standard price; the stand-alone price. And that's the stand-alone price in the absence of bundling.

MR. GLAZER: Mm-hmm.

COMMISSIONER CARLTON: Now, it seems to me there were two problems. The first is, I don't see that that's a relevant benchmark. In other words, we know that bundling allows you to charge different prices to people. So imagine a simple monopolist who has to charge $10 to everybody. And now you say you can charge different prices. He charges $12 to one person, $8 to another. The prices change.

So the question is, why is it relevant that the but-for price that you'd use to distinguish between incentivizing and coercing—or your standard, really, of what a violation should be, the stand-alone price in the absence of bundling?

MR. GLAZER: I’m not sure I completely follow the question, but—

COMMISSIONER CARLTON: In other words, in the absence—you need a stand-alone price—

MR. GLAZER: Yes. And that—and my stand-alone price is the price that was in effect—

COMMISSIONER CARLTON: Before the bundling.

MR. GLAZER: Well—it was the price that was in effect before the monopolist conceived the scheme to—

COMMISSIONER CARLTON: Yes. And my question is, why is that relevant?

MR. GLAZER: Well—

COMMISSIONER CARLTON: Isn’t that requiring a discriminating monopolist to be judged by the standard of a simple monopolist, in terms of pricing. In other words, there’s no logical connection I can see between the two, between the standard that you’re using to determine harmful behavior.

MR. GLAZER: Yes—I guess I’m not completely following the question.

COMMISSIONER CARLTON: Okay—well, let me just move on, then.

Suppose you can’t observe a stand-alone price.

MR. GLAZER: Mm-hmm.

COMMISSIONER CARLTON: You don’t have your fact situation.

MR. GLAZER: Mm-hmm. Yes.

COMMISSIONER CARLTON: Then I assume things would get more difficult.

MR. GLAZER: Yes.

COMMISSIONER CARLTON: Yes.

MR. GLAZER: Yes, I recognize there may not—it may not always be clear, and you may end up having a battle of experts on that question.

COMMISSIONER CARLTON: I'll follow up on that with Will.

MR. TOM: Yes.

COMMISSIONER CARLTON: You've done a lot of work on bundled discounts. Do you agree that if a case involves bundled discounts, it's a mistake to find liability unless you do some price-cost test?

Regardless—we can disagree about what the right price-cost test is, but if you fail to do a price-cost test, that seems like an error. I'm referring to *LePage's*, but I don't want to get into the details of *LePage's*.

MR. TOM: Yes, I think, certainly in the kind of institutional setting we're talking about, where there are some really significant harms to false positives, I think doing some kind of price-cost test is going to be fairly helpful in weeding out cases that we ought not to bring.

COMMISSIONER CARLTON: Does anyone disagree with that proposition, on the panel?

PROF. SALOP: Yes, I do.

COMMISSIONER CARLTON: Okay. Do you want—a short answer, Steve?

PROF. SALOP: In the following sense, in order to do the price-cost test, you'd need to have a price benchmark. And it's possible that the proper price benchmark was a price below the status quo. It's also possible the proper price benchmark was above the status quo.

And, you focused on the latter, where the price would have been higher but-for the bundled discount. But it could be lower.

A firm, knowing that it is going to face a price-cost test, could raise its price so it would be able to show the profit loss. So you have to contend with that issue.

COMMISSIONER CARLTON: Okay.

PROF. SALOP: And I think that is in the Sibley article.

COMMISSIONER CARLTON: Will, your article is the only one—your paper—that stressed economies of scale. And I was actually a little surprised. Maybe I missed it in the other papers.

But a central element of recoupment is not just the economies of scale, obviously, but that there be sunk cost. And I assume you probably meant to include sunk costs in the economy-of-scale argument.

Isn't that a crucial condition for all of these arguments in which people are saying—people are using bundled discounts to drive someone out of business, or you're using predatory pricing. Isn't the existence of sunk costs and economies of scale a critical element of proof that the plaintiff should require? Otherwise, there can be no recoupment.

MR. TOM: I think that's right. And I stressed the point for that reason. I mean, you need to have some theory as to why this practice allows the perpetrator to achieve power over price. And absent—to take the distribution situation which is often where it comes up—absent economies of scale at the distribution level, it's hard to see why the manufacturer can't simply induce distribution of its own, or enter the distribution segment itself.

So yes, I think that is a critical element.

COMMISSIONER CARLTON: Okay. Let me just—I'm running out of time. Let me just end with one question having to do with *Aspen* and *Trinko*.

And since I'm an economist, not a lawyer, I need some legal advice here. And that is that, when I read *Trinko*, there are two elements that people stress—and also when they discuss *Aspen*. One is that *Aspen* had a prior course of dealing, and that I understand. And we can debate whether that's a good or bad condition. And then the other aspect they mention is that there was a refusal by Ski Company to accept a voucher from Highland. Okay?

Now, let's forget about the prior course of dealing. Suppose there were no prior course of dealing. I just want to focus on this refusal. And let me—so we don't get hung up in the facts of *Aspen*—imagine the following example—and let me ask Rick this question.

I'm a monopolist of an input. I'm using my input to make product A. I'm selling my input to a lot of other people who make outputs B, C, D and E, and I'm charging them different prices. Someone comes along and says, Dennis, sell me your input. I'm going to compete with you in A.

First, am I required to sell it to him? Do you think I should be?

And, two, if I am required to sell it to him, at what price? The highest price I charge anybody, or the lowest price?

MR. RULE: Well, in the interest of full disclosure, because you know how I view—

COMMISSIONER CARLTON: And I'm asking this question because Rick was one of my very best students that I ever had in an antitrust class—assuming the answer is correct.

MR. RULE: Everything I know I owe to you, Dennis. So there you go.

[Laughter.]

I guess, in the interest of full disclosure, I would say that the way I read *Trinko*'s reading of *Aspen Skiing* is that they're trying to make lemonade out of lemons, perhaps, and ferret out a way to, as much as possible, confine *Aspen Skiing* to its facts.

And it was therefore possible in the *Trinko* case to identify the factors that you identified, and distinguish *Trinko*, and come to a sensible outcome in that case.

Aspen Skiing, by the way, is a classic example of the no-economic-sense case. And it is one thing that I guess I regret a little bit from my days in the Antitrust Division that I didn't—that the government didn't tell the Court that it ought to come out the other way. But, as I recall, it was because they had a very good counsel who came in and convinced me that there was no economic reason for the company to refuse to take the vouchers. So, again, I think that's one of the reasons that the test is problematic.

But I think you're pointing out another one, which is, if you have a rule like that, how do you make it operational? What do you tell your client?

Now, I guess what I would advise my client, because clients, frankly, don't like to take a lot of risks, and in light of *Trinko* or *Aspen Highlands* read by *Trinko*, they might very well decide it's better to deal on some basis with this party than not. And I would feel, I think, reasonably comfortable if my client were prepared to offer the price that it offered at the highest level to someone, to A.

Now, it's not—I think, in light of *LePage's* and other cases, that's not going to necessarily certainly protect them, because A—or whatever letter it was—may hire good counsel who, in turn, might hire Professor Salop here, and come up with an argument as to why it's a problem. And, of course, that then gets back to the question of, is it really worth it to try to go after that kind of conduct because of all the problems it causes?

COMMISSIONER CARLTON: Steve would like to—

PROF. SALOP: I think that both those cases—*LePage's* and *Aspen*—show the problems of bad lawyering, as much as anything else.

In *Aspen*, the defendant systematically dropped all of the issues that they might have had, so that the case you actually saw at the Supreme Court was an imaginary fact situation case in which most of the important issues disappeared.

But it's quite clear that the voucher part of the case was not the key, and it was not what the *Trinko* Court said. The *Trinko* Court focused on the fact that Ski Company refused to sell daily tickets to Highlands at the price that they sold tickets to other people in bulk.

My remark about *LePage's* is a matter of burden of proof. 3M didn't try to show that prices remained above cost. 3M shot itself in the foot. Had they simply chosen to prove that the incremental revenue was above incremental cost, they probably would have won. But they chose to take the lazy approach of just throwing the burden on the other side.

COMMISSIONER CARLTON: Okay. Thank you.

CHAIRPERSON GARZA: Well, Dennis said that he's a lawyer and not an economist—I'm sorry, he's an economist, not a lawyer.

[Laughter.]

He was doing a good job—he was doing a good job of his questioning. But I was going to say, Dennis is an economist not a lawyer, and I'm a lawyer and not an economist. And so I can't even begin to parry with Professor Salop on some of the more esoteric discussion of the things in his paper.

I come to this issue, sort of joining the chorus in concern about *LePage's*—and come to it as a lawyer, having witnessed just what a counseling nightmare it has become and, in my view, how it actually has, in fact, chilled procompetitive behavior, competitive behavior, and has even potentially been anticompetitive.

I also believe, like many of the others here today, that maybe instead of picking and choosing among certain standards, what we really ought to be thinking about is how best to improve the administrability of Section 2. It's something, if we don't take Mr. Rule's suggestion and try to repeal it in order to reduce the cost—the direct costs of enforcement, the cost of false positives and false negatives, and the costs to the economy of uncertainty.

But I have to say, I don't know where to go with it after that, because I find all the shortcuts that people have suggested trouble me. The NES test and the profit- sacrifice test seem to have problems.

But, Professor Salop, your test, the consumer-welfare-effects test, also troubles me. I think it's the same thing that, in the next panel, Prof. Pitofsky refers to as the ad hoc test. And I think the name says it all. I think the problem is that it's too ad hoc. And I had a number of questions I wanted to ask you about it.

You anticipated some of those questions in your testimony, and then you got me really worried. Because one of the things that you said was that you thought, well, maybe—I think you acknowledged that the questions that you say need to be answered are very difficult, the benchmarking and the various other things. And you suggest that maybe what we need is the FTC to look at it. Or maybe we need a regulatory body. And then you point to sort of the old form of regulation that we had for durable monopolies.

But it troubled me that we would be going—that a modernization trend would take us to having a regulatory body regulate monopolistic conduct. And I was also a little bit troubled by the notion that—and, actually, I'd ask you whether you really think that it's the case that there are all these sort of situations of durable monopoly power, if there's an empirical basis for that, and whether that's something that you'd need to see? In other words, if the monopoly power wasn't necessarily durable, might you have a different view of the correct standard to apply?

PROF. SALOP: Well, first of all, I said I think antitrust is up to the task. Where I'm concerned is that other people do not think antitrust is up to the task.

So you should not be troubled by my testimony. I'm confident that antitrust can be fixed—not in the way that Rick would like to fix it, which I think is more or less the way I fixed our cat.

[Laughter.]

But, rather, I think the right answer is to give guidance to courts, educate the courts. And I don't think courts are as dumb as lots of other people do.

Now you asked me another question: do I think there are monopolies in the economy? That's a pretty big question. If—

CHAIRPERSON GARZA: No, no—durable. I think you were saying—you used a reference to durable monopoly power.

Is it your assumption that—

PROF. SALOP: I think that's a fact issue that needs to be dealt with in antitrust cases, whether the firm actually has durable monopoly power or not.

If you look at the Easterbrook article that Rick alluded to before, he says that there are a lot of false positives in the economy because there are no barriers to entry in most markets. That was a good criticism of the way antitrust was carried out in the '60s and '70s. But you no longer have those false positives any more. Now, you only bring monopolization cases when firms really have monopoly power, where there are barriers to entry.

CHAIRPERSON GARZA: Well, who are the "we" bringing monopoly cases only when firms really have monopoly power? Where do you—is there some sort of pre-screening committee out there?

PROF. SALOP: Yes. I think it's called summary judgment.

CHAIRPERSON GARZA: Uh-huh. Well, you know what, the only thing I'll say before the light turns red is that you mentioned that *Trinko* and *Aspen Skiing* were cases of bad lawyering. I guess my concern is that—

PROF. SALOP: I didn't say *Trinko*, I said—

CHAIRPERSON GARZA: Oh— *Aspen Skiing*—

PROF. SALOP: And *LePage's*.

CHAIRPERSON GARZA: —and *LePage's*. But my concern is that bad lawyering, in that sense, may be more of the rule than the exception. And I'm frankly concerned that while your effects test is probably, ideally, the right thing to do, I'm not sure that, as a practical matter, it's very administrable. But that's more of a statement than a question.

And I will pass it on to Commissioner Jacobson.

COMMISSIONER JACOBSON: Thank you. I have a disclosure to point out initially. It has been my privilege for some 27 years to represent the Coca-Cola Company. And Ken Glazer, from the Coca-Cola Company, is a member of the panel. I can assure you, however, that his thoughts, which he and I have discussed previously at some length, are not, in fact, shared one-to-one by me, although I always appreciate the insights.

But Ken has been speaking independently of the Coca-Cola Company, and I will endeavor to fulfill my responsibilities independent of any of my client relationships as well. But I did want to point that out.

CHAIRPERSON GARZA: We assumed that. I think the disclosure is the 27 years.

COMMISSIONER JACOBSON: It'll soon be 28.

MR. GLAZER: And also for the Coca-Cola Company, these are all academic questions. I hope everyone recognizes that.

[Laughter.]

COMMISSIONER JACOBSON: And as Professor Salop pointed out, the screen of summary judgment has worked very well.

Getting to the issues at hand, I do have a couple of questions, largely for Mr. Popofsky. But I would like to make the observation that I don't think it's accurate to describe a consumer-welfare analysis as ad hoc. Properly conducted, the inquiry should be one to determine whether the conduct creates or facilitates the exercise of market power and, in that respect, leads to higher prices—at least in a seller case—and lower output in a relevant market and in that respect should not be different than the same analysis undertaken under Section 1 of the Sherman Act.

So it is possible to have a balancing or consumer-welfare test that is cabined by fundamental antitrust principles. And I would hope that those scrutinizing the consumer-welfare test would keep that in mind.

My question for Larry is, when we talk about applying the *Brooke-Group* test in a bundling context, are we talking about applying a price-cost test, in the sense that Mr. Tom was talking about—incremental revenues versus incremental costs? Or are we talking about looking at the total cost of the bundle of products, and the total revenues received for the entire bundle?

MR. POPOFSKY: I think the answer is in Professor Muris's paper, at the very end. And I think it is the incremental approach, not the total.

COMMISSIONER JACOBSON: Because the total cost would fundamentally treat the bundling aspect of the conduct as irrelevant—isn't that fair to say?

MR. POPOFSKY: I think it's arguable that that would be the result.

COMMISSIONER JACOBSON: Okay.

And I think your point in *LePage's* was that there was no effort on the plaintiff's part to determine whether the incremental-revenues-versus-incremental-cost test was even satisfied—no evidence at all.

MR. POPOFSKY: I must confess—coming in not as the lawyer who did something bad somewhere—

[Laughter.]

—but as an appellate counsel only—

[Laughter.]

—I was dumbfounded by the concession that was made by LePage's that the sales were all above cost however measured (incremental, total, attributed)—they did not contest the point. And you find that in Judge Greenberg's dissent, which, happily, mirrored our briefs but was the dissent, unfortunately.

I think one could live with almost any price-cost test that would, after all, be administrable. It's one thing to say, I'm going to put a balancing test to the jury and talk about grand concepts of consumer welfare, and let the jury balance it—and the juries have no idea whatsoever what you're talking about. That is simply fiction to them.

What they see is a big guy being sued by a little guy, and that the big guy has done something the little guy doesn't like. And it looks like the big guy rolled up his monopoly muscle and did something bad.

And then the judge gives a bunch of instructions—

after all, the instructions in *Aspen*, if you read them, are among the most appalling general instructions imaginable. They were blessed by the U.S. Supreme Court. They're mirrored in the practitioners' books. And that's what ends up in jury instructions. And they provide absolutely no meaningful guidance whatsoever—unfortunately, to judges, as well. And hence you have a complete abandonment in these three cases that I mentioned—*LePage's*, *Weyerhaeuser*, and *PeaceHealth*, and there are others, although some are going the other way—you have a complete abandonment of a rigorous price-cost analysis of some kind—to echo Professor Carlton—which could give the court the ability to either give guidance if there was a contest over cost, or to take the case away from the jury—one way or the other.

COMMISSIONER JACOBSON: Mr. Rule, do you have a view, in the bundling context, of the incremental-revenues-against-incremental-costs test referred to by Mr. Tom in his paper, and the earlier paper of David Balto and Neil Averitt?

MR. RULE: Well I haven't—I will be honest, I haven't, as I should, devoted adequate thought and attention to Will's article. I'm sure he's right, because he's always right.

But I will say that I agree with Larry. I think that there ought to be a price-cost test. I think there ought to be a rule that—and I would say it's probably a cumulative rule—that there has to be pricing below some measure of some proxy for marginal cost, whether it's a discounting case or a predatory pricing case, if one wants to pursue those sorts of cases.

One other thing I would like to just address in a previous question.

It seems to me that a consumer-welfare test is like a no-economic-sense test and everything else. It's good, and in fact, if somebody asked me, how would you like to describe the test—or the approach that ought to be taken, it's clearly consumer welfare. I don't think today there's any debate about that.

I think the issue is, how do you—can you really develop a cost-effective rule for evaluating it in these circumstances? And I guess I would quibble, at least, with the notion that because we do it in Section 1 we can clearly do it in Section 2.

I think it's inherently easier to try to evaluate whether or not conduct typically among or between competitors, which has the object or the effect of directly raising or exercising market power, and then trying to compare that with efficiencies, that that is inherently easier. And it's inherently easier to come up with standards for doing that than trying to do what's necessary in unilateral conduct cases that involve exclusionary conduct. It's also true of vertical cases, I'll add. And that is because the immediate effect, frankly, in most cases, in the economy is generally good for consumers, because it generally involves providing some product on terms that they like, lowering costs or something.

And it’s not the immediate harm that you have to worry about. You have to draw a causal link between that harm that you can see, and that’s the basis of the case, and some harm to consumer welfare, broadly speaking. That is very difficult.

Then it’s very difficult because you’re one step removed—you’re speculating about the harm—to compare that to actual benefits or procompetitive effects.

And so it seems to me that you’ve got to recognize that in a typical Section 1 case, it’s just inherently easier to come up with a balancing, or a rule-of-reason approach than it is in these cases.

COMMISSIONER JACOBSON: I’ll leave that to professor Salop to respond to. My red light has been on for some time. But I’m sure Steve will work that in.

CHAIRPERSON GARZA: Commissioner Kempf?

COMMISSIONER KEMPF: Yes, I’ll start with a disclaimer. Having just retired as a general counsel, I don’t currently represent any company in anything.

[Laughter.]

Now, if I hang up a shingle in January and I invite all of you to have me represent everybody in everything—

[Laughter.]

When I think of monopoly power, I'm reminded of Mel Brooks's wonderful observation that beauty is in the eye of William Holden.

[Laughter.]

There's a lot to that. And I always think of rate cases like the *United States v. General Motors*, a monopoly in the bus industry. The case concluded about six months before GM went out of the bus business because it went broke. And the *IBM* case that dragged on forever, and was finally wound up at a time when IBM was an also-ran in virtually every product that was subject of the lawsuit.

So I'm not sure I see a lot of monopolies—or any.

I have a couple comments, and I have one question.

When I listen to Professor Salop's remarks, he said the principle criticism of his framework is that it's too complex. And I wouldn't say that's the principle criticism. I'd say not that it's too complex—it's bad, would be the principle criticism I've heard, and that, when you say, antitrust is up to the task and we should be more sophisticated, most of your critics say that's just an invitation to open the door to random considerations of all factors leading to random outcomes that hearken to Frank Easterbrook's observation that when everything is relevant, nothing is dispositive.

The resulting analysis is unanchored, and instead of better schooled, it becomes basically unschooled, and the net result is that a statue aimed at promoting competition becomes a vehicle to prevent it. It's used principally not on behalf of consumers, but on behalf of competitors to give people products that aren't very good at a price that's too expensive. And what the Supreme Court once described as a statutory regimen is a consumer-welfare prescription and instead becomes a band-aid for people who do not serve the public well and are looking to someone to protect them from that.

So I would ask, against that background—

[Laughter.]

—but I really would want Larry Popofsky to comment on—

[Laughter.]

—what can we do? I notice you have three series of cases you discuss, and you present a series of problems. And my question is, what should we as a Commission do in the light of that, in terms of recommendations to Congress and the President?

MR. POPOFSKY: You know, Don, I thought you were terrific when we opposed each other in court. And you were going fine until I became the target.

[Laughter.]

COMMISSIONER KEMPF: No, no—he *was* the target.

[Laughter.]

I don't think anybody missed that.

MR. POPOFSKY: The correct result in each of the cases I discuss, and the area which I focused on, are variants, it seems to me, of what the Supreme Court determined was an appropriate approach in *Brooke Group*. All suggest that you must have some kind of price-cost rule that is administrable, which, after all, solves the problem that Judge Easterbrook mentioned, and while not necessarily perfect—after all, I quote Voltaire for the proposition that the enemy to the good is the perfect—but which nonetheless produces a result that approximates consumer welfare as we understand it, even though we understand that there are going to be exceptions. In *Brooke Group*, after all, limit pricing as a strategy was passed as lawful, however reluctantly.

So my sense is that the only way you can solve this problem is to adopt some kind of price-cost standard that judges can understand and—God help us—juries can understand if there are contests that go to a jury.

COMMISSIONER KEMPF: Let me ask you to comment on one aspect—

PROF. SALOP: Don, can I answer? Could I also answer?

COMMISSIONER KEMPF: Yes, go ahead.

[Laughter.]

We were on a panel about nine years ago, and you said, can I answer that? And I said no, I'm running the panel, and you can't. But today—

PROF. SALOP: You've grown up since then.

Look, first of all, the enemy of the good, in the movie, was the bad and the ugly.

[Laughter.]

The perfect was really a secondary problem. I've got one comment and one question.

The comment is, you can't use a total-revenue/ total-cost test for bundled rebates. Because if you do that, then the firm—all it does is bundle the rebate with more and more products over which it has monopoly power, and the rule gets weaker and weaker. If you make 100 products, instead of just bundling one with another, you bundle all 100 with the other, and then you have more price-cost margin to use in order to show that, overall, your average price is bigger than your average cost.

The question is one for Commissioner Kempf and that is, I've produced a two-page legal standard. It's intended to be something that's administrable. So, what exactly is bad about it?

I understood you said—

[Laughter.]

COMMISSIONER KEMPF: I would like to answer that, but the red light is on.

[Laughter.]

CHAIRPERSON GARZA: I can actually—since it's red, we'll move on to allowing the next Commissioner to ask the questions.

Commissioner Shenefield?

COMMISSIONER SHENEFIELD: First, thank you all very much for submitting what, to me, were very helpful papers. So I'm grateful for the time and effort you took.

Rick, I thought one of the most enlightened decisions you made during your time in office was your decision to withhold your hand in *Aspen*. And I continue to congratulate you for it.

MR. RULE: That was good lawyering.

COMMISSIONER SHENEFIELD: Other than Mr. Rule, is there anybody on the panel that would favor the repeal outright of Section 2?

[No response.]

Does anybody on the panel think the world would be a better place if Section 2 cases could be brought only by the government?

MR. GLAZER: If you got rid of treble damages, I think that—

COMMISSIONER SHENEFIELD: Well, we'll come to that in a minute. But just the government, for now.

The record—in the absence of any sound, the record shows nobody raised his hand.

Would the world be a better place if Section 2 cases were brought for injunctive relief only?

No takers there, either.

MR. GLAZER: You're getting closer.

MR. POPOFSKY: You might get some takers on that one—yeah. You're getting warm. I think that the incentives are perverse with treble damages, and the pressures for settlement are escalated too heavily, in my view.

But, you think of the odd case—*Lorain Journal*, for example, or where a plaintiff has been driven out of a business, where damages—at least single—would be appropriate.

COMMISSIONER SHENEFIELD: What about trying cases to the court, and not to juries? Would that improve the world at all?

MR. POPOFSKY: Well, the Third Circuit thought so once upon a time.

COMMISSIONER SHENEFIELD: What do you think?

MR. POPOFSKY: Didn't it say in passing that a case could be, quote, "so complex that the jury trial right would not apply"?

I don't think it's worth trying to venture a view, in light of the Seventh Amendment.

COMMISSIONER SHENEFIELD: Anybody else have a view on that?

MR. GLAZER: Yes—I would commend to everyone a chapter from a book called *The Jury*. I can't remember his name. It's a *Wall Street Journal* reporter. But the book was all about different jury trials, one of which was the *Brooke Group* case. And it's pretty—well, the old line about sausage-making—it's pretty ugly.

COMMISSIONER SHENEFIELD: Don Turner always thought it was ridiculous that Section 2 cases should be tried by a jury.

Will, on page 12 of your statement you make a—maybe even in the last line—you make a reference to sort of addressing institutional frailties and shortcomings—something of that sort? And I was curious what you have in mind?

MR. TOM: Well, I certainly had it mind the track that you were on in the line of questioning you just started. Certainly, if we were in an environment in which treble damages were unavailable for these kinds of practices, I think that would be a substantial improvement over the current state of affairs.

But for the Seventh Amendment, if we could avoid trying these kinds of cases to a jury, that would certainly be an improvement.

And I think, to the extent that any de-trebling proposals gain traction, then I think we may not be quite as aggressive trying to cut back the substantive rules which, after all—I mean, even the most aggressive substantive rule—aggressive in the sense of pro-enforcement—I discuss in here is, as Judge Posner pointed out, under-inclusive—we might not be so under-inclusive if the case were being solely brought under Section 5 of the Federal Trade Commission Act, for example.

COMMISSIONER SHENEFIELD: One final question to Professor Salop, and I just want the record to be clear. Were you really proposing—or were you proposing that there should be a reference to some now non-existent regulatory agency in cases of durable monopoly for some sort of adjudication? Did I understand you correctly?

PROF. SALOP: First, let me say something about treble damages.

I think that if the Commission is going to think about de-trebling, they should also, as part of that, think about whether single damages really would get the plaintiff —the winning plaintiff—actual single damages. Bob Lande has written some articles showing that actually, treble damages, in practice, amounts to much less than trebling.

COMMISSIONER JACOBSON: We had a lengthy hearing on that subject at which he testified.

PROF. SALOP: My issue about the non-existent regulatory agency—I was saying that antitrust is up to the task, but I was making an observation that antitrust is used instead of regulation. When you have a problem in the economy with a durable monopoly, the traditional way that has always been handled in the United States is to regulate the monopoly, to make sure that they only charge a reasonable price, that they don't charge a terribly super-competitive price.

In antitrust, we say, well, courts are not public utility commissions. Public commissions—that's what they do, not what antitrust courts will do. But if you're going to suggest getting rid of Section 2 so there are no constraints on the monopolists, then the natural institutional response would be to regulate them in the way we've always regulated them.

COMMISSIONER SHENEFIELD: But you're not suggesting that.

PROF. SALOP: No, I think you ought to educate —if you think there's a problem with the courts, you ought to educate the courts.

COMMISSIONER SHENEFIELD: Thank you.

Madam Chair.

CHAIRPERSON GARZA: Commissioner Valentine.

COMMISSIONER VALENTINE: Thank you. Since I've only got five minutes, I'll get going, notwithstanding thanks to everybody.

Let's say that this unusual alliance of Mr. Rule and Mr. Salop wins the day and that we become convinced that, in fact, the consumer-welfare competitive-effects test is the correct way to be assessing potential harm under Section 2.

And now we want some administrable rule to look at bundling. And I'd like to ask each of you what that rule would be.

Will, we'll start with you. You mentioned Posner's incremental-price-over-incremental-cost on average perhaps not catching certain things. What would you adopt if you were questioning that?

MR. TOM: I think I've made clear that I am perfectly willing to be under-inclusive, particularly in the current institutional setting that we're operating under. And so, given that setting, I think an incremental price/incremental-cost test makes a good deal of sense.

The hard question for me is, what do you need in order to prove that incremental price is below incremental cost? What do you get to a jury on, and how is a jury supposed to decide in a real case, where and what those exact prices and costs are? Aren't they going to be pretty darn ambiguous?

And I think my own view is that despite all the qualms that we have about relying on so-called "intent evidence"—that's kind of what courts do, that's what juries do, that's what courts at least are trained to do, and we have to help them sort out the useless intent evidence.

COMMISSIONER VALENTINE: So your test would be incremental price/incremental cost?

MR. TOM: That would be the test.

COMMISSIONER VALENTINE: Okay—let me keep moving on.

Ken, you say that in the incentivizing conduct instance there's no principled basis for treating incentivizing conduct—even when exclusivity streams are attached—any more harshly than alleged below-cost pricing—and so we should use a *Brooke Group* standard.

But on the next page, you say that if there’s no coercion case—involves incentivizing—and the only question is whether the incentives are so great that they cross the line into predatory pricing. And answering that question, it makes sense to ask what would happen if we attribute the rebates on X to product Y (attributing all the rebates–

I’m not sure those are consistent. But tell me what your test is at the end of the day.

MR. GLAZER: Yes, because—well, first, you ask, was this coercive? And just to use *LePage’s*, it’s either express or implicit. There is no evidence there that it was express. And you ask, did 3M refuse to sell Scotch Tape to customers who didn’t buy its private-label tape? Well, no; there’s no suggestion of that. Then you ask, did they play around with the pricing in such a way that effectively they were refusing to sell Scotch Tape? And there was no suggestion of that in the case. Therefore, you conclude it’s not coercive.

Then you say, well then, we’re dealing with an incentivizing case. And there you ask, if the plaintiff can satisfy the factual predicate that these rebates on the Scotch Tape really were designed to get the customer to buy the private label—you’d have to satisfy that factual predicate. But once you’ve done that, then you have a basis for attributing or allocating the rebates on the Scotch Tape and/or Post-It Notes and whatever else they were putting rebates on—the bundle—you apply those over to that product, the private label product—I think it's a relatively straightforward approach.

COMMISSIONER VALENTINE: Okay.

Mr. Rule, where do you come out on this?

MR. RULE: You know, I would agree with Larry, but in this sense, I think *Brooke Group* is an appropriate standard, not so much because of the cost-price rule, although I think that ought to be an element, but because of recoupment.

I've always read *Brooke Group* and sort of the cases that led up to it as indicating recoupment being important. And to me, that's symbolic of the need to actually show a link between this behavior and harm to competition in the sense of a reduction in output that is sort of sustained over a period of time.

And the problem, I think, in *LePage's* is it wasn't shown. There are a whole lot of ways I could—you could go through the example—and maybe this is one that you've probably thought about in your career—a similar kind of discount is travel-agent commission-override. And as some of you know, the Department of Justice over time has investigated that, and always concluded that there wasn't a problem.

And there are a whole lot of reasons that they don't work very well in being exclusionary. Part of the problem with *LePage's* is they didn't really look at whether there was an exclusionary result. After all, LePage's stayed in the market. They weren't making as much money, but they were still in the market.

So I think if you think about recoupment or some test like that, that's a key; that will weed out a lot of things. I think if you get, somehow, past that, then you've still got a—I think there ought to be a price-cost test. But I think recoupment is the key to an appropriate standard.

COMMISSIONER VALENTINE: Can we allow Mr. Salop—or my time's up—as well?

CHAIRPERSON GARZA: Did you have an answer—

PROF. SALOP: I've already answered this question.

COMMISSIONER VALENTINE: So your piece for unilateral refusals to deal goes to all Section 2?

PROF. SALOP: No, no—I mean my piece on refusals to deal is only about refusals to deal.

I answered the question in response to—earlier. I'm happy to repeat the answer.

[Laughter.]

CHAIRPERSON GARZA: Very briefly? I mean, just as a—

PROF. SALOP: Yes, basically, incremental price-incremental cost, but you need to worry about the benchmark.

COMMISSIONER VALENTINE: Okay.

MR. POPOFSKY: Might I just have one comment on the last question?

CHAIRPERSON GARZA: Sure.

MR. POPOFSKY: One of the reasons recoupment does not seem to be so central in the cases that I've mentioned is that presenting that to an appellate court when you've lost a jury—when someone's lost the jury—is a very different thing than presenting a price-cost test to an appellate court.

You have a fighting chance of convincing the court—or so you think—that there is a rule which has been departed from or violated. With recoupment, intrinsically it is projecting forward in time to a set of circumstances that never happened, and instructing the jury about that, and then trying to convince an appellate court that the jury somehow didn't have substantial evidence to make the judgment they made.

That's a hard road.

COMMISSIONER JACOBSON: It convinced six justices in the *Brooke* case, though.

MR. POPOFSKY: Absolutely did. The justices.

COMMISSIONER JACOBSON: Not all appellate courts. Apparently not all.

[Laughter.]

CHAIRPERSON GARZA: Commissioner Warden?

COMMISSIONER WARDEN: Thank you.

Does any member of the panel, other than Professor Salop, believe that his two-page test that he supplied for unilateral refusals to deal is something that business executives can readily conform their conduct to on a day-to-day management of their business?

[No response.]

Does any member of the panel believe that it would be understandable to a jury?

MR. GLAZER: I guess my answer to that is, even with—I don't know whether business-people would or would not, but my concern is that, if they understood the test and conformed—I'd be concerned that we wouldn't have enough innovation in the economy, that it takes away too much incentive.

COMMISSIONER WARDEN: I appreciate that addition. But my question really was, could anyone understand it and operate his business in conformity with it?

UNIDENTIFIED PANELIST: I would like to adopt Commissioner Warden's questions as part of my answer to the question.

[Laughter.]

COMMISSIONER WARDEN: Does anyone on the panel believe that treble damages should be awarded in situations where there is lacking clear notice of illegality to the actor who has to pay the damages?

PROF. SALOP: I'd like to abstain on these questions, because they're ones that I haven't thought through. And this panel is about refusals to deal, not about other things.

COMMISSIONER WARDEN: Okay. That's fine. Your abstention is noted.

Does anyone on the panel believe that the general concept of exclusionary conduct under Section 2 is clear in the minds of those operating the business enterprises of this country?

PROF. SALOP: I would say I think the ones who are well counseled understand it.

COMMISSIONER WARDEN: So, every day, you're supposed to have Rick Rule at your elbow, while you run your business—is that your position?

PROF. SALOP: I would not begin to respond to that.

[Laughter.]

COMMISSIONER WARDEN: Perhaps they should have you at their elbow.

MR. GLAZER: I think maybe in one discrete there—below-cost pricing. I've seen some signs that there's some—that's been taken on board by business-people.

COMMISSIONER WARDEN: I think your point's well taken.

Finally, and then I will yield—Professor Salop, I did not hear an answer to the question that has been asked by two Commissioners already: can you identify any durable monopoly in our economy that was not created by state franchise or license?

PROF. SALOP: Gee, let me think. East of the Mississippi, or west of the Mississippi?

COMMISSIONER WARDEN: You can have the whole country, even Hawaii.

PROF. SALOP: Microsoft.

COMMISSIONER WARDEN: That's a durable monopoly?

PROF. SALOP: That's a durable monopoly.

COMMISSIONER WARDEN: Okay. Thanks. No further questions.

[Laughter.]

CHAIRPERSON GARZA: But, John, it's still green.

COMMISSIONER WARDEN: John Shenefield asked a lot of what I intended to.

CHAIRPERSON GARZA: Okay.

Commissioner Cannon?

COMMISSIONER CANNON: Gee, that's probably the example of, you may not want to ask a question you don't know the answer to. But—

UNIDENTIFIED VOICE: Oh, he knew the answer.

CHAIRPERSON GARZA: He knew the answer.

COMMISSIONER CANNON: You know, I just had this vision all of a sudden of having Rick Rule at everybody's elbow.

[Laughter.]

I thought about that commercial about Ping the clone, from AARP, where there are like thousands of Rick

Rules all over the country.

MR. RULE: We're working on it.

COMMISSIONER CANNON: Well, I was going to say, with eight or nine children, you're probably on your way. That's great.

[Laughter.]

Rick, it's interesting—looking at your top-ten list there, and thinking, gee, there's obviously no way that Section 2—I assume you're saying you think not only would Section 2 never be repealed, but also—how do you incorporate any of this? Are you talking about trying to amend Section 2? Or just—to me, this looks like something in a judicial education course where you're trying to educate judges about how you should really look at this stuff.

MR. RULE: I think it's fair to say that that is closer to the spirit in which it was intended than legislation.

Some of the suggestions are ones that are highly controversial but I think would improve the state of the law, like when you have true unilateral refusals to deal, as opposed to something that looks like an exclusive deal in your conditional agreement—I think it should be per se lawful. Okay?

Now, that's not the state of the law, except in the area of intellectual property, as I understand it, in the Federal Circuit. But I think that would be an appropriate approach for a court to take.

Now, I don't think—I mean, it would be nice if I could educate judges to adopt these kind of rules, but I will say that I recognize that while the law would be better for them, in my opinion, it's probably also true that I haven't yet—or no one has yet—convinced judges to accept—at least all of it.

COMMISSIONER CANNON: Does anybody else on the panel agree with any of these top-ten lists? The reciprocal here? Does anybody on the panel think that any of these ideas are—

Steve, you're saying—you're shaking your head—I guess no, huh?

PROF. SALOP: No, I agree with a couple of those.

COMMISSIONER CANNON: Oh, really? Which ones?

PROF. SALOP: Reserve Section 2 for real durable monopolies; require the plaintiff to prove consumer harm.

I'm looking at the headlines. In the text—he goes a lot further in the text.

[Laughter.]

But limited to the headline—yes, some of these make sense.

COMMISSIONER CANNON: Ken, or Larry? Anybody? Other comments on this?

MR. POPOFSKY: Well, my own observation was that a lot of these say nice things, as did the jury instructions in *Aspen*. But how you translate that into real-world operational rules, and adjudication, and price seems to me to be beyond reality—even if he's at the elbow of every single corporate general counsel.

COMMISSIONER CANNON: Well, but at $1,200 an hour, I mean, what a great thing. That would be fabulous.

MR. GLAZER: Then he'd be a monopolist if he was.

[Laughter.]

COMMISSIONER CANNON: That's true.

MR. RULE: I'd be a public utility.

COMMISSIONER CANNON: You know it's interesting. This morning, we had a state action panel, and we kind of got to the same point. Every time we try to push up against the substantive issue here, we end up kind of getting deflected off to more procedural things like, how about no treble damages? What if a jury—this was not in the hands of a jury, but a judge? It seems to me that we're almost at that exact same point again.

And I was wondering, has anybody on the panel had experience—and maybe nobody's done this—where you've actually gone through—well, actually, some have—a jury trial, gotten a jury verdict on something like this, and then been able to go and talk to the jurors after the trial and understand what they understood, or what they thought the case was all about?

MR. GLAZER: Yes. I didn't personally interview the jurors. I was in the *Brooke Group* case—the trial. But this *Wall Street Journal* reporter—I remembered his name—Stephen

Adler, did that, and he wrote it up in a fascinating account.

But they were not spending a lot of time talking about elasticities of demand and efficiencies.

COMMISSIONER CANNON: It was just like the big guy versus the little guy? Or—how did it come out? What was the basis?

MR. GLAZER: Yes, I think the notion of evil—

[Laughter.]

COMMISSIONER CANNON: Yes, it always gets back to evil.

MR. GLAZER: The documents played a big—you know, "Squish them like a bug"—no, not "squish them like a bug;" that's another case—But "put a lid on Liggett," those sorts of documents.

COMMISSIONER CANNON: Yes, I've got it, I got it. Okay.

That's all. I see my time's about up. So thank you.

CHAIRPERSON GARZA: Commissioner Delrahim?

COMMISSIONER DELRAHIM: Thanks. Two quick questions.

One is, with the *LePage's* issues—and I think at this time, the best consensus you're going to get from anybody in the public policy arena is something similar to the SG's brief that was submitted to the Supreme Court—but not being an economist, I'm going to try my best here to explain this situation.

If discounts offered on the whole bundle were applied to one product, and the price was still above cost, would anybody disagree that that should be per se lawful?

PROF. SALOP: We've all gone through that already. I mean, it's—

COMMISSIONER DELRAHIM: That it should be per se lawful?

PROF. SALOP: That's the incremental-price-incremental-cost test.

No, I think you need to worry about the benchmark. You need to figure out whether that's the right benchmark. If you use that test without adjusting the benchmark, there could be false positives or false negatives.

COMMISSIONER DELRAHIM: Let me go just to the quick second question, and that is—and Commissioner Shenefield was getting to this—for Section 2 violations, if you went with just injunctive relief, if legislation was proposed for just injunctive relief and single damages, would anybody oppose that? And I know Mr. Salop raised the issue of incentives for plaintiffs to bring lawsuits, but they bring lawsuits in other areas where there's not treble—

COMMISSIONER SHENEFIELD: What if it's true single damages, as measured by Bob Lande?

[Laughter.]

PROF. SALOP: Difficult question. That question would take a lot of study.

I think it would be great for you to call for follow-up work on that question.

MR. RULE: Can I just add something? It strikes me that—particularly since, as I recall it during our administration, we proposed something like single damages for victims of exclusionary conduct.

I certainly think it would make things better. So I don't want to—by my silence in response to your questions, I don't want to suggest that I think it's a bad idea. I think, though, it's probably good, but at the end of the day it may be a little bit like a tear in the ocean, because I think you still have some pretty fundamental problems that it doesn't address.

MR. POPOFSKY: Commissioner, if I can just respond.

I think the incentives for the plaintiff's side would be perfectly protected by the right to counsels' fees. And single damages works in all sorts of other areas—coupled with a right to a fee.

And I don't understand why, in this day and age—I know the history of the treble-damages remedy—I don't understand why, in this day and age, this vestige from an earlier set of perceptions and concerns remains.

COMMISSIONER DELRAHIM: Professor Salop, would that satisfy you?

PROF. SALOP: I think you need to do a big study of this.

[Laughter.]

This is too big a question to answer—

COMMISSIONER DELRAHIM: That's what we're doing.

MR. RULE: Didn't you do a study of this once?

PROF. SALOP: Yes, we did a study and we found that you couldn't draw that conclusion. But that was 20 years ago. Maybe the world's changed in 20 years.

COMMISSIONER DELRAHIM: The benchmarks of that study being what? What would you need to find in order to allow for that?

PROF. SALOP: You'd need to figure out what the impact would be on the amount of litigation, and the types of cases that would be deterred by de-trebling.

For example, suppose you found that what de-trebling did was eliminate all the good cases, but all the bad cases remained. Then you'd conclude that de-trebling was not a good idea.

But if the results were the opposite, then you'd conclude it was a good idea. But that's the kind of study you'd need to do.

COMMISSIONER DELRAHIM: Thank you.

CHAIRPERSON GARZA: Commissioner Litvack.

COMMISSIONER LITVACK: I only have two questions. I don't know if this should be directed to Professor Salop, or Rick Rule, or one of my fellow Commissioners—but I'll address it to Professor Salop to start with.

What is a durable monopoly?

PROF. SALOP: A monopoly that's protected by barriers to entry.

COMMISSIONER LITVACK: Over time?

PROF. SALOP: Well, it's hard to conclude after one week that a firm's got a durable monopoly, so—

COMMISSIONER LITVACK: Five years? Three years?

PROF. SALOP: It would depend.

COMMISSIONER LITVACK: Ten?

PROF. SALOP: It would depend on the situation.

COMMISSIONER LITVACK: So we don't know it's a durable monopoly—

PROF. SALOP: Until we study—

COMMISSIONER LITVACK: —until the end.

PROF. SALOP: Until we study it. Okay? Easy answers make bad law. I'm an economist. I think you need to study this.

But maybe you could know at the very instant that they got the monopoly. For example, the court in *American Airlines* found that, at that moment that Braniff accepted Crandall's invitation to collude, they would have a durable monopoly. Sometimes you might know in the twinkling of an eye. Other times you might need to wait. It's going to depend.

COMMISSIONER LITVACK: Okay.

My other question really goes to the practitioners on the panel.

Having sat by the arm of the CEO on some of these same issues, and having been in a business position trying to deal with some of these issues, my sense—and I guess I'm wondering about your experience—is that, despite all this conversation, despite the tests that we're creating, despite what you're telling the jury ultimately, or the judge ultimately, as a practical matter, when making the decision about whether to implement whatever the behavior is—if it's Scotch Tape, or 3M, or whatever it may be—the decisions are made—and I hate to put it this way—on a rough-and-ready basis, based on the facts that you have at the time; it's a judgment call; and it's a weighing. And we can articulate all the rules we want, and we can recommend all the legislation we want. It will perhaps insulate or protect at the outside end, assuming there's a lawsuit.

But in terms of the behavior, businessmen have to make those judgments based upon the law as it now stands, and the cases that interpret it, and there is an uncertainty and always will be.

And I guess my question is, is that consistent with your experience? And I'd ask any one or all of you to comment?

MR. POPOFSKY: Well, as a practitioner, I would say yes, that's absolutely the way it happens. There are a few, but only a few, truths that guide that process. One is, you can't sit down with a competitor and talk about price—you know, those sorts of things.

You need something like that, I think, here with predatory pricing. *Brooke Group* gives it to you, even though you have the recoupment escape valve perhaps. But there are very few, and they're useful. I don't think 3M, for example, had the faintest idea that what that strange discount policy was doing was remotely illegal. At its core, on a couple of the big customers, it was essentially a super-volume discount, and nothing more.

If I may just go back to one other thing on this question of a study that Professor Salop raises—the treble-damage remedy may be usefully varied, depending on whether or not there's been a prior government prosecution. That changes the equations pretty big-time, in terms of incentives. And if he was going to do a study, he should look at that one and its impact.

PROF. SALOP: Of course that might apply to some more egregious things, and you would want to encourage that kind of case.

COMMISSIONER LITVACK: Well—

Rick, can you comment?

MR. RULE: Sure. I think you're absolutely right. And the thing that's always missing, I think, in a courtroom is that process. And typically, the way it comes up, as I'm sure you know better than almost anybody in this room, business-people want to do something. And they may or may not be able to articulate to the satisfaction of an economist or an antitrust lawyer why they want to do it. But they think it works; they think it's important for their business. You sit down; you try to tell them what the risks are; or are there ways to minimize those risks, and then ultimately, they make the decision.

But I will say that I do think there are—and in my experience, there have been—times when business-people wanted to do things that, frankly, I thought were, on balance, beneficial and enhancing of consumer welfare that they didn't undertake, or they didn't undertake in a way that was as efficient as it might have been, because of the in terrorem effect of certain antitrust rules and wanting to avoid them.

Now, that's not true of all clients. It depends on the situation the client's in. But I do think that it actually does have a negative impact on doing things that probably, at the end of the day, would have been beneficial, but they don't do it because of the cost that it would entail.

PROF. SALOP: I would like to add—I counseled two—I mean, I'm not even a practitioner, but I was hired by practitioners in the late '80s and early '90s. We counseled two clients on *LePage's* type discounts. So it's not like it was impossible to understand that it would be a potential problem, or that it could be analyzed.

And so I'm really surprised by this. I understand that business-people may not go along with your advice, but it's not like these are issues that never arise.

COMMISSIONER WARDEN: How long did it take you to do that?

COMMISSIONER LITVACK: The point I was going to make—and this was my only point: within my limited experience—and I don't mean to suggest that it couldn't be otherwise—rarely—and I won't say never, but rarely do clients or companies, when they want to undertake a business practice, engage in a big, long economic study. By the time they're done with the study, the market has passed them.

Businessmen want to do things yesterday. And judgments are made—I'm not saying it's perfect; that's the world in which we live—based on the facts as they exist. And studies are good; they're great, and to the extent that they exist, or you have the time to do them, terrific, but I think 95 percent of the time, you don't.

PROF. SALOP: Would you feel the same way if this were a panel on the issue of whether a company should put safety features into their cars?

Also—you know, it's what they want to do.

COMMISSIONER LITVACK: I'm not making myself clear. I'm not making the point that it's what they want to do and therefore they should do it without regard to what the law is. That's not the point. And the point on safety, I think, is inapposite to this.

What I was trying to say is that studies perform a useful function, and to the extent they exist, they're great. But in the real world in which most of us live, things move too quickly, and decisions are made without the ability to do the kind of study that you would like to do.

And so I'm just pointing out that the reality is that we've got to make judgments based on the situations as they're presented to the lawyers—or the economists—at the time. Rarely do you have the luxury.

MR. TOM: If I can add one thing on that point. I think the counseling problem is analogous to the problem that I talked about, about what evidence you need in the litigation context.

In the counseling setting, you're mainly relying on business-people's intuitions about why they are doing this. Are you doing this in order to make better products? Cheaper products? Sell more products? Or are you doing it in order to deprive rivals of the ability to compete with you, even thought it's costly?

COMMISSIONER LITVACK: What's the impact? Is that what you're really asking, Will? You're asking a client— Never mind. I understand why you want to do this. You think it's good. What's the impact? Who's going to be hurt?

PROF. SALOP: Aren't there antitrust compliance programs at all large companies?

COMMISSIONER LITVACK: Everywhere.

PROF. SALOP: Every large company has an antitrust compliance program. And if they didn't have an antitrust compliance program, you would know.

MR. GLAZER: And I can tell you that 85, 80 percent of it is focused on Section 1-type issues, as it should be.

COMMISSIONER CANNON: Will, have you ever asked that question and gotten a different answer for the first part of that answer?

CHAIRMAN GARZA: Let me move to our final questioner, Commissioner Yarowsky.

VICE CHAIR YAROWSKY: Okay. Of course it's very helpful.

CHAIRPERSON GARZA: We've got three minutes.

VICE CHAIR YAROWSKY: Okay. All right.

I want to go back to the concept of time. We saw this ten or 15 years ago with predatory pricing. We talked about it today—a little bit about monopolization.

But what about refusals to deal? I know we can't be precise, as you said, Steve, but when does that kick in? Conceptually? Because in monopolization cases, if there's a durable monopoly—well, at that magic moment, I guess that's when it kicks in, from that point on.

Predatory pricing, we learned, was a little more difficult.

How about refusals to deal? What's the appropriate time frame to judge the effects?

MR. RULE: Well, again, I personally think that the cost of trying to judge and distinguish anticompetitive refusals to deal from procompetitive refusals to deal, and the in terrorem impact on incentives, and what it says about someone who succeeds in the way we want them to succeed to get a monopoly, that if you get it, you're going to be limited in terms of how you use it, which I think inevitably reduces the return and the incentives—

I just think that it doesn't make a lot of sense to me to try to condemn it. And let me make just one point, because I know it's not exactly on point to what you said, but I've been itching to say it for two hours.

Part of the problem—people like Dr. Salop and Dr. Carlton are very smart. And I have a lot of confidence and faith in their abilities. But I guess I don't have a lot of confidence and faith in the ability of economic science to answer a lot of the questions that get heaped on them in tests like Steve's. And if you don't think they're going to be accurate, or if you think the cost is too great, it's just not worth it.

And with refusals to deal, it's just hard for me to see why you should distinguish between a monopolist and a non-monopolist. So it's hard for me to answer that question.

But I certainly think—and my point about durable monopolies—I would say that—again, any answer to the time period is arbitrary—if something is going to dissipate in less than five years, probably less than ten years, it's going to dissipate on its own before you ever get all the way through litigation. So why worry?

VICE CHAIR YAROWSKY: On the state-action panel that we had this morning, one of the perceptions I had was that we are at such a mature state of talking about state action that we're kind of almost lost in the nuances. We also have some structural issues—the federalism.

When we met last week with the EU, they had the certainty that comes with having no nuances in a lot of ways. But it was kind of invigorating to hear them talk about their perspective.

Is there anything—I don't have any case in mind whatsoever—but is there anything about the way they've used the abuse of a dominant position that should be instructive to us?

MR. GLAZER: I can answer that. Actually, in my paper for this I said frankly I didn't really know what the answer is on this—what I call a horizontal type of case. But actually, by coincidence, I was forced to study the *IMS Health* case because I had to speak about it on another panel last week.

And, actually, I think that that might be a case in which I think it might be legitimate to find a—it might be appropriate to enforce sharing, because of the unusual circumstances in that case. Basically, I think it was sort of a very strange copyright that was given to the defendant that allowed him to sort of take complete control over an entire industry standard, keeping rivals out.

So I would commend the Commission to study the *IMS Health* case as a possible example of a case in which maybe you should impose a duty to deal with a rival.

PROF. SALOP: So is that a situation because they had control over the standard that made it more risky?

COMMISSIONER VALENTINE: The problem is that it is state-granted intellectual property rights. So it's nothing that would, in fact, happen in this country.

MR. GLAZER: And it's not that the plaintiffs there wanted to deal with—they wanted to deal with the defendants; it's not as though they wanted to free-ride on the defendants' facilities. They would have preferred not dealing with it at all. But they had to go and get a license from it because the German court said there's a copyright here.

PROF. SALOP: Sometimes a firm has got such a strong standard that it's as if it was given by the state. It's too difficult to dislodge it. So I'm not sure why you would treat that differently.

COMMISSIONER VALENTINE: Madam Chairman?

CHAIRPERSON GARZA: Yes.

COMMISSIONER VALENTINE: Can I ask—I know this is way out of order, but I thought of one question—

CHAIRPERSON GARZA: Okay.

COMMISSIONER VALENTINE: —that I would very much like to be able to pose to the panel that includes Mr. Popofsky—and we're going to lose him in—a minute ago.

CHAIRPERSON GARZA: Deb, do you think we can—because we've got another panel coming in. If we can do it within the next few minutes?

COMMISSIONER VALENTINE: Yes. It's very, very simple—which is: most people have actually said all we should do is tell the Department of Justice and the FTC to litigate with rational, good standards, and we tell them what standards to use. And we may all agree on those standards.

But it just occurred to me that the jury instructions in *LePage's*, apparently were the jury instructions in *Aspen* that have come up several times. And one question is: who essentially agrees on these jury instructions? I'm not a trial—I have to confess, I'm an appellate lawyer. Could we ask the ABA and the agencies, in conjunction, to recommend to the judicial council that, in fact, there be better, more evolved jury instructions—and even separate out for refusals to deal, or bundling, or whatever?

COMMISSIONER JACOBSON: I would commend you to the 2005 ABA Antitrust Section civil jury instructions, which are an improvement—although they continue to have ambiguities in this area, as any jury instruction, given the law today necessarily would. But that is the state of the art on jury instructions right now.

MR. POPOFSKY: And that is, in fact, what is used.

CHAIRPERSON GARZA: So the *Aspen Skiing* instructions were in the ABA?

MR. POPOFSKY: The ABA instructions often mirror what they understand the case law to hold. Hence, they mirror *Aspen*.

CHAIRPERSON GARZA: I think Debra was asking maybe whether there's a more formal mechanism to actually have the Judicial Conference or somebody say, here are our recommended jury instructions in antitrust cases, which would be more in line with—God knows what we would come up with.

MR. POPOFSKY: If anybody thinks they can do a better job than the ABA Antitrust Section, more power to them.

There are number of practitioners on both sides of the aisle who spend an enormous amount of time in that process.

COMMISSIONER LITVACK: I think the point that Larry is making also is that the instructions must be consistent with the existing law—

MR. POPOFSKY: Exactly.

COMMISSIONER LITVACK: I mean, the judges—what do we say, here's a nice instruction for you? It's true, it ignores *Aspen*, and it ignores what the Supreme Court said, but we think it's good.

MR. POPOFSKY: And then you get in a conference over the instructions—

COMMISSIONER VALENTINE: Were the instructions used in *LePage's v. 3M* the ABA model rules?

MR. POPOFSKY: It was not used in *PeaceHealth* because they took the language out of *LePage's* specifically with reference to bundling, and instructed the jury on the theory that that was the applicable law.

The case had just come down.

CHAIRPERSON GARZA: Were there bundling instructions before *LePage's*?

MR. POPOFSKY: I don't think that there were bundling instructions in the ABA book before *LePage's*. I don't think anybody thought that they—you'd have to be pretty clairvoyant to have seen it coming.

COMMISSIONER JACOBSON: They were willful-acquisition or maintenance-of-monopoly-power instructions. Nice illuminating instructions.

PROF. SALOP: Nobody read the *Ortho* case?

COMMISSIONER JACOBSON: I guarantee it was read and footnoted at best in the prior edition of the jury instructions, which I think came out in '81. It was a long time between editions; it was about 15, 20 years.

So *Ortho* may have come after the prior edition. I'm sure it was footnoted in the current edition. But to what effect, I don't know.

CHAIRPERSON GARZA: Well, we are—thank you very much to the panel. And thank you for staying a little bit over.

Again, we appreciate it. We appreciate that these are complex issues, and we thank you for subjecting yourself to our questioning today.

[Applause.]

[Break taken between panels.]

CHAIRPERSON GARZA: Back on the record.

In consideration for our witnesses, who have some time commitments, we'd like to start. The Commissioners will come in as they do.

First of all, I'd like to welcome our panelists, and thank you for appearing at the hearings this afternoon. We've appreciated the papers that you've submitted, and are looking forward to this afternoon.

You may have witnessed, in the prior hearing, or heard from staff about how we do this. But let me just quickly review it. What I'll do is ask each of you to summarize your testimony in as close to five minutes as you can do that. Once that's done, then we will lead with Commissioner Jacobson as the primary questioner for the Commission. He will take 20 minutes to ask questions, and then following that, we'll allow questions by each of the other Commissioners.

I've been asked by the court reporter to remind everyone, both Commissioners and panelists, to pull his or her microphone up close so that she can get everything that's being said. All of the hearings are being transcribed, by the way, and the transcript will eventually be put up on the website for everyone to see. And all of the statements are on the website as well.

So I traditionally start with my right, and I will do that today, as well, and ask Professor Muris?

Panel II: Refusals to Deal and Bundling and Loyalty Discounts

PROF. MURIS: Professor is fine.

CHAIRPERSON GARZA: All right, Professor Muris, if you would begin. Thank you.

PROF. MURIS: Thank you very much, Madam Chairman. It's a pleasure to be back in this room where I've spent much my life. I was telling someone in the hall that the three years Bob Pitofsky left the FTC were the three years I started in the four different jobs I had here—two were consecutive. I'm not sure what that all means, but it's true.

Let me just make a few brief points about the issue on which I wrote, bundling. I'll talk not just about the paper, but also about the experimental economic evidence.

To put the issue in context, we're obviously dealing with the need to have administrable rules. And economics, like it has on so many other issues, has told us that an enforcement regime should minimize the sum of the direct costs of the parties in litigation and the error costs. You've already heard a lot about various errors. The direct costs, of course, can be quite large as well.

Bundled discounts are a ubiquitous phenomenon in our economy, as I think we all know. And it's only been very recently that, both in the case law—in any systematic sense—and in the economic literature, people have begun to come up with theories about why bundled discounts could be a problem.

Because they are so widely used in competitive markets, that fact certainly suggests that when they're used by firms with large market shares that there's no reason to believe that the efficiency explanations that apply in competitive markets don't also apply to the firms with the large market shares.

There are theoretical articles by economists recently—particularly Barry Nalebuff at Yale, and David Sibley and his colleagues, who have, as of yesterday, a new draft. It's a little more nuanced than the previous draft, and both suggest certain conditions under which bundled discounts could be anticompetitive. Although oddly—particularly, I find this odd—the focus of this literature is on exclusion and not on the impact on consumers. In Barry Nalebuff's articles, for example, he makes the clearly correct theoretical point—and obviously it's practically true as well—that a firm that bundles could harm a competitor who doesn't bundle.

And the key question is, does that have an impact on consumers? In an article taking all the Nalebuff equilibria, Tim Brennan shows that consumers are better off. I think that Barry Nalebuff's response is that he's concerned about what happens in the long run, because of the exclusion. Yet, the long run is outside of his models, and is what the *Brooke Group* and the recoupment test are all about.

Another preliminary point is the idea of an equally efficient competitor. There's been a focus—and Herb Hovenkamp, for example, has adopted this test—that this is a much narrower and much more sensible test than the *Brooke Group* test. It may even make sense as a safe harbor, if one could limit it that way, which I doubt.

The problem is with the idea that the bundle excludes an equally efficient competitor.

Even if you look at Hovenkamp's recent article, it has the same issues as the Nalebuff standard, because clearly, consumers are better off with the bundle than without it. The competitor is excluded, and what you're left with, again, is consideration of the long run and the issue recoupment raises.

More fundamentally is the issue of what economists call economies of scope, and what I've tried to summarize on page 12 of these slides. All else being equal, how can a firm that offers you less of what you want be equally efficient with a firm that offers you more? I thus have trouble with the whole idea of equally efficient, unless the cost savings and the benefits are allegedly trivial.

Now, let me just me just talk very briefly about the experiments.

Vernon Smith is the recipient of the Nobel Prize and is at George Mason, where I teach. Fortunately, his group is next to the law school, and they've been working on bundling. They've tried to make the best case for bundling being anticompetitive. That has turned out to be very hard to do. In fact, no matter how they've jiggered their experiments, they've had trouble systematically showing that bundling harms consumers.

Moreover, these problems exist with a 100-percent monopolist, without efficiencies, and with highly correlated values of the consumers between the A market, in which there's a monopolist, and the B market in which there are competitors. When they add a small competitor in the monopoly market, when they add efficiencies, and when they change the correlations, they find that bundling invariably increases consumer welfare.

This result is consistent with the reality that bundled discounts are overwhelmingly a beneficial practice for consumers.

Thank you.

CHAIRPERSON GARZA: Thank you.

Mr. Pate?

MR. PATE: Thank you very much, Chairman Garza. It's a pleasure to be here to appear before the Commission.

I'm a little bit different than the other panelists. I'm not a professor. I'm very sure I'm never going to win a Nobel Prize. I'm just a regular working lawyer who's trying to give advice to clients who are trying to decide how to make decisions day to day when they run their businesses.

So therefore, my short testimony, predictably, was based on the need to have administrable, relatively clear rules that firms can use based on the information they're likely to have when they make those decisions.

I think if you strive for rules like that you'll have the additional benefit of adopting rules that will avoid chilling procompetitive conduct by firms with high market shares, but at least you'll have that practical benefit.

When I was headed back to private practice I had lunch with Andy Gavil, who is promoting the theory that Justice Lewis Powell was the author of the key decisions that modernized American antitrust law. Now that I'm back at Hunton & Williams I've found that this seems to be a theme of Andy's that should be promoted widely. And I went back and looked at a speech he had given me that Lewis Powell gave in 1967, and he said, at that point, with respect to antitrust law, that the lines are so nebulous, with courts constantly exploring new theories, that even experienced counsel cannot give definitive advice.

And it seems to me that we are in exactly that same place all these years later, with respect to unilateral conduct under Section 2.

Let me try to briefly summarize where I was on the four specific questions that you posed. First, when should refusals to deal violate Section 2? And does *Trinko* state the right standard? Again, I don't have anything particularly surprising or novel to say, since I so recently departed the Antitrust Division. I think the joint Federal Trade Commission/DOJ brief that was filed in the *Trinko* case sets forth the best standard that has been developed to date, which is a standard that asks whether business conduct makes economic sense, apart from the elimination of competition? This is a standard that's consistent with the case law that has been developed to date. It's a standard that I submit that businesses are going to be able to make decisions under much more readily than the alternatives that are proposed.

The *Trinko* standard—well, the case doesn't purport to adopt an explicit standard for decision. It certainly is consistent with a no-economic-sense test. Certainly, its profit-sacrifice emphasis with respect to its description of *Aspen* is consistent with some variation of this approach. So I think it's positive.

What it certainly does is make clear that the concern about false positives and chilling procompetitive conduct is going to apply across the board with respect to all aspects of Section 2, not just pure predatory pricing cases.

I talked a little bit in the written testimony about why I think this test is better than, for example, a consumer-welfare balancing test. The only point I would stress in the statement is simply that the agencies use a balancing, rule-of-reason, consumer-welfare, broad approach in evaluating mergers. It doesn't tell you anything at all about whether that's going to be a useful tool for businesses to make decisions with respect to unilateral conduct.

When a merger is being reviewed the agencies have information from both parties directly involved in the merger. They have the ability to get information from other parties and to consider that in the context of a discrete event that is going to be at least an unusual event in the life of the firm. It seems to me that's very different.

Essential facilities—no, I don't think there's a stand-alone essential-facilities doctrine that can plausibly be maintained after *Trinko*, even if there was before.

With respect to bundling, on which Tim focused so well, the clear message I would bring there is that I think some objective standard is needed. It looks like everyone agrees that the *LePage's* opinion has brought confusion to the law, and has not been a positive contribution. Should we have *Ortho* as a screen? Should we have the *Brooke Group* test? I think there's room for debate there. At the end of the day, maybe the *Brooke Group* test is the only one that could be administered.

I wish that the Court had been presented, in the record before it, in *LePage's*, with more choices of potential screens, and don't think it was a good case. But, obviously, something better is needed.

Should you promote new legislation? I would suggest that you should not. It seems to me that the Chamber of Commerce, and the National Association of Manufacturers, are not going to allow Professor Salop's version of Section 2 to be enacted; neither is the trial bar likely to stand by while Rick Rule's version of Section 2 is adopted. And I'm not sure that anything that we would get is in any sense likely to be better than having those of us who really do care about these issues continue to work through them in the courts.

Thank you very much.

CHAIRPERSON GARZA: Thank you.

Professor Pitofsky?

PROF. PITOFSKY: Thank you, Madam Chairman. And thank you for inviting me to join this very distinguished panel.

I'm going to be brief about bundling and essential facilities, because I really want to talk about refusals to deal and what kind of rule is appropriate there.

On bundling, virtually everyone who submitted a paper tends to agree that bundling is pro-consumer—it is a way of discounting; it's a way of waging competition. And we should be very cautious about blocking bundling. I tend to think the *Brooke Group* test makes sense. The bundle should be above some standard of cost.

The only issue is, when you have multi-product bundling—suppose there were ten products in the bundle, and one rival makes only one of the ten products, what do you do to protect that rival if he says, well, the customer received a three-percent discount on Product 1, three-percent on Product 2, and three-percent on Product 3; I have to meet a 30-percent discount, and that's more than I can handle?

My answer to that is Phil Areeda's answer. You allocate three percent to each product. And after allocation, each product should be above some level of cost.

On essential facilities—a couple of points. One, *Trinko* says the Supreme Court never really confirmed the essential-facilities doctrine. I disagree with that. I don't know how you read the Supreme Court opinion in *Otter Tail* without seeing that as a single-firm essential-facilities case.

Second, it's frequently said, well, some lower courts go along with this doctrine. It's not some lower courts; it's dozens of lower courts—who are faced with real problems of a monopolist and someone who can't get access to an input. Without that input, the rival company can't compete.

Third, it is said that many scholars scorn the doctrine, think it's empty and unwise. I don't think that's quite right. Even the scholars who are most adverse to the essential-facilities doctrine, Professor Areeda and Judge Boudin, say what you should do with essential facilities is be very cautious, limit it scrupulously, and clarify what the standards are.

But someone like me, who thinks essential-facilities is an appropriate approach to antitrust—I would say exactly the same thing: be very cautious, use it sparingly, and set out the standards more clearly.

So I think there's room for a doctrine, but it's very narrow in scope. And I think that's where the Europeans are moving in their essential-facilities cases as well.

Now—refusals to deal by a monopolist. That, I think, raises a fascinating set of issues. And while I admire what Hew Pate and the DOJ did in their *amicus* brief in *Trinko*, I don't quite agree.

First of all, I believe the rule now, under Section 2, is that behavior is illegal if it's unreasonably exclusionary. That's a balancing test that takes into account anticompetitive effects, business justification, and maybe a look at a less restrictive alternative. That's the same rule that we apply in all non-per se areas of antitrust: boycotts, exclusive dealing, mergers, and joint ventures.

But when we discuss Section 2, we get all this talk about false positives, that a jury can't handle these complicated questions, that monopoly is good in some respects—and it seems to me—well, first of all, that last argument really flies in the face of everything about antitrust for well over a hundred years.

It is true that a balancing test—confirmed, I think, by the unanimous opinion in *Microsoft* and in *Aspen*—is a problem because it's vague, it's uncertain, and it's hard to predict. But we do it. That's what we do in antitrust and in so many other areas of the law.

The Department of Justice, in an admirable effort, tried to come up with a less vague overriding rule. But the rule, it seems to me, is that, unless the behavior evidences no economic sense but for the anticompetitive effect, it must be legal. Such behavior is in a safe harbor. I think that's not a good substitute for the admittedly imperfect balancing test.

First, the economic sense might be an efficiency. That will be the usual situation. But what do you do about a case where the anticompetitive effect, by raising barriers to entry, is 50 or even 100, and the efficiency is five or ten? Are we going to say in that situation, wrap it up; there's no case to be brought here?

Second, economic sense focuses on the seller; why did the seller do it? Did this seller sacrifice profits? Did the seller have a reason for doing it? I think antitrust should focus on the consumer, and not the seller. So the test, I think, looks in the wrong direction.

Monopoly is good! Avoid false positives! I don’t see where those arguments are coming from.

Judges and juries can’t handle these questions? The issues are very difficult. It would help if the judge could give better instructions—as somebody raised on the earlier panel. But, as compared to absolute, per se legality, which is the result of the any-efficiency test, as opposed to handing the question to a judge and a jury, I can’t see why you would have absolute legality.

Perhaps the most difficult issue is as follows: mandatory dealing is not enough in itself. Somebody’s going to have to set the price and the terms of sale. I agree that is complicated, but I think the problem has been exaggerated.

The fact of the matter is in almost all cases I’m aware of, the seller who’s refusing to deal had previously dealt with the party, or was dealing with other parties in comparable markets. And I don’t see why that can’t be the benchmark. *Microsoft*, *Intel*, *Aspen*, *Otter Tail*, *Kodak*—all of them. You don’t have to go back to first principles to figure out what a fair price is. The market showed you what a fair price was.

Finally, I think the problem in this area has been made worse by confusing two issues. One is, what is a monopolist allowed to do? And the answer is, a monopolist is allowed to accumulate monopoly rents. That's why companies fight so hard to achieve a monopoly.

The other question is, what kind of behavior maintains or achieves the monopoly power unfairly, inappropriately, undesirably, or in a way that's anti-consumer? And that, it seems to me, is where we're trying to come up with a rule. And, given all its imperfections, I think a balancing test remains the better approach in this area.

Thank you.

CHAIRPERSON GARZA: Thank you.

Professor Shapiro?

PROF. SHAPIRO: Thank you. I appreciate the opportunity to be here with you today.

My first main point is going to be pedantic. Which is: this notion—refusal to deal sounds like a simple category to define: you're not dealing with somebody. But it's really not so easy at all. And I guess you know that, but I want to emphasize, that as my statement indicates, there are many different types of refusals to deal, and I think it's actually pretty hard to cabin-in refusals to deal from pretty much all of Section 2 when you include conditional refusals to deal—so, I won't deal with you if you buy from my competitors. I won't deal with you if you're trying to integrate and compete with me, whatever.

So I think it's very important to distinguish conditional from unconditional refusals to deal. And conditional refusals to deal, I think, require the sort of fact-based inquiry, depending on what the conditions are that are being imposed. It could be exclusive dealing. By the way, a fact-based careful inquiry, not an ad hoc inquiry—not an ad hoc test—

So a fair bit of what I have to say is really more directed at—really the beginning of it—unconditional refusals to deal.

I'm thinking that the monopolist controls an input that is very useful downstream, and they want to use that internally and not sell it to competitors or would-be competitors. Now, you can call that an essential facility. To me, if you've got control over an input, I don't know how an "essential facility" is different than that anyhow.

So, as you see in my statement, if it's an input the monopolist is simply using internally for downstream production, and unconditionally just doesn't share it, doesn't sell it, I don't see any basis for imposing a duty to sell in that case.

Beyond that case—just give you a context, where I'm coming from: I'm an academic economist. This is true. I confess to such. But I'm also a practitioner as an expert witness and consultant to companies, including antitrust-compliance types of issues sometimes. And I give a lot of weight to two practical considerations. I just want to again emphasize those.

First, I really think that everyone kind of recognizes that the courts are very poorly suited to regulate the terms and conditions of dealing. So if you're going to go into this area—particularly for an input that hasn't been shared, you're going to have to say, well, they sell it to somebody else, or they used to sell it to somebody, and we'll use that as a benchmark.

And that gets complicated, too. Because now you're effectively engaging in some sort of prohibition on price discrimination. And so then we have to ask why. We don't normally stop monopolists from price-discriminating, unless it's going to harm competition in some other market rather than simply exploit the monopoly they have. So it gets more nuanced at least.

And, secondly, I think—I testified in the *Kodak* case, and I admit that some of my views are colored by that. It's so easy for the plaintiffs to say, well, if you would sell your monopoly input, that's better than my alternatives. So if you'd sell it to me, I would become lower cost or a better competitor, and that will be good for customers. So that's obviously procompetitive. So I want you to sell it to me. It's like the defendant has to say, well, that competition doesn't count; or it's my stuff, so you can't have it; or, well, in the long-run interest of consumers we have to protect property rights—defenses that are significant and important economic issues, but don't necessarily play very well in front of a jury—at least unless the jury instructions or the law is going to say something in that direction.

So I think, as a practical matter, there's a real danger that this can lead to, essentially, price regulation at some cost-based level that is not going to reward the innovation that led to this monopoly in the first place.

In the *Kodak* case the Court effectively said *Kodak* had to sell hundreds of parts at certain specified prices which they had been selling—transferring them internally, or selling them to a few customers. So that sort of regulation is going to be difficult.

I do distinguish the situation where there is a sharp change of policy that can exploit or enhance monopoly power, particularly if there's been some misrepresentation, and consumers are being exploited in an opportunistic sense. So, changes in the course of dealing, particularly if there's been misrepresentations I think need to be scrutinized pretty carefully. And I would point out that in that case, there need be no profit sacrifice. If I've led people to believe, I'm going to have an open interface, or other open policies, and I've established a market monopoly power on that basis, and then, having secured that position, I then make all that more proprietary, there may be no sacrifice, that may be the profitable thing to do now and going forward, and yet that can certainly reduce competition, and I'd be concerned about that in some cases. Again, it's a difficult—it's a complex inquiry, but I'd be concerned about it.

Lastly, 30 seconds on bundling. I support the incremental-revenue-versus-incremental-cost test, or safe harbor, I should say, that if the incremental revenues are greater than the incremental costs, then that should be a safe harbor, just as the overall—some version of price versus cost is used in *Brooke Group*, for standard predatory pricing cases.

I do not think it's a good idea to use an overall revenue versus cost, because as was pointed out in the previous panel, that's effectively going to allow virtually anything. If somebody has a strong monopoly over Product A with a large margin, they can throw all sorts of other stuff in—even reduce the margin for basically a negative incremental revenue, and that would fall into a safe harbor if you did it on total cost and revenue. So I don't think that's a good idea.

But the incremental does, I think, is worth, and it should be pursued. There's some nuances in doing it that I can talk about in questions. So I favor that. And I think

LePage's is a problem.

Thank you.

CHAIRPERSON GARZA: Thank you.

Commissioner Jacobson?

COMMISSIONER JACOBSON: First, thanking this extraordinary panel for just high quality written and oral presentations. Hopefully, the questioning will be a tenth of the caliber of what we received. And my thanks, and all of our thanks, to each of you.

I would like to start out with what I think is a simple question, but perhaps it isn't.

Do each of the four of you agree that, as a general first principle, antitrust is aimed at preventing actions that change competitive markets into markets characterized by monopoly power or significant market power?

Is that a fair general principle?

PROF. PITOFSKY: But, of course, if you move from non-monopoly to monopoly through superior skill, foresight, and industry, that's okay.

COMMISSIONER JACOBSON: And that's a fair qualification—provided that the conduct is competition on the merits, or superior skill, foresight, and industry—as some would characterize it. With that qualification.

PROF. SHAPIRO: I have to qualify it further, I'm afraid. I mean, if a monopolist takes over a complementary market—let's say by vertically integrating or adding an integrated product—that could be a good thing rather than a bad thing, because it could avoid problems with double marginalization and the like. So, in that case, the complementary market appeared to be competitive, but it was actually a derivative market of the monopoly market.

So, understood properly, I agree with the statement. But the fact pattern I'm talking about, probably you might—

COMMISSIONER JACOBSON: Well, no, that's where I was heading.

And why should antitrust policy not be hostile to conduct other than competition on the merits in the second product, the product being monopolized? Why should antitrust policy not be hostile to conduct that creates or facilitates the exercise of market power in the second product market?

PROF. SHAPIRO: Well, my view would be that if controlling the second market is going to make it harder for others to compete effectively in the primary monopoly market, antitrust should be quite hostile to conduct that does not amount to competition on the merits in the complementary or secondary product market.

COMMISSIONER JACOBSON: But it's a wash in the first market.

PROF. SHAPIRO: A wash in the first market?

COMMISSIONER JACOBSON: A wash in the first market. The only effect is the creation or enhancement of market power in the second market.

PROF. SHAPIRO: Well, if you're approaching it that way then it sounds like consumers in the second market are harmed, so then it would be anticompetitive. So we should watch out for that.

But just looking structurally at controlling the second market isn't going to answer the question. I have to see what happens in the second market; whether consumers got a better deal because of an integrated product, or they got a worse deal because of reduced variety and higher prices.

COMMISSIONER JACOBSON: Professor Pitofsky?

PROF. PITOFSKY: I think that's too tough a rule that you are advocating. I think there are things that a monopolist ought to be allowed to do that may entrench its monopoly to some extent, but in a very modest way, and may have efficiency justifications.

A monopolist can tie up ten percent of the distributors in a particular market. I don't think there's anything wrong with that. It may help the monopolist, but it's not so severely anticompetitive that the antitrust lawyer should step in.

So let me come back to the formulation I suggested earlier. I think the conduct has to be substantially anticompetitive. There have to be no efficiency justifications that outweigh the anticompetitive effect; and you can't get to the efficiencies in some less restrictive way.

There are lots of reasons why we should be careful, cautious, pay a lot of attention to business practices by a monopolist, but I would not say that the sole defense is superior skill, foresight, and industry. I think there are some other things a monopolist can do that are too modest in effect for the antitrust laws to bother with.

COMMISSIONER JACOBSON: What sort of efficiencies would you look for? Would you confine the efficiencies examination to the second market? Would you look at both markets in combination? How would you look at the efficiencies question?

PROF. PITOFSKY: Well, if you read the FTC-DOJ Merger Guidelines on your question, we said they had to be inextricably interwoven in order to take both markets into account.

To tell you the truth, I'm comfortable taking both markets into account. I know, in *Philadelphia National Bank* and elsewhere, courts have said it's too complicated for us to weigh efficiencies here and inefficiencies there. It is. But I think, in clear cases, it can be done. So I'd take both markets into account.

COMMISSIONER JACOBSON: Well I'm 0 for 2 with the interventionists—

[Laughter.]

PROF. PITOFSKY: You're not likely to fare much better with my colleagues.

[Laughter.]

MR. PATE: I agree with much of what's been said so far. But my basic problem with the articulation is that I don't think we're going to get agreement on what competition on the merits means. I don't think it's really a term that has any content.

And the concern I have in the situation that you're talking about is, again, whether consumers are going to be worse off over the long haul if firms are discouraged from innovating. And one of the things that is most familiar to us in terms of beneficial innovation is the addition of a new feature or a new capability to a product.

And so, specifically, for example, in the context of software, which was at issue in *Microsoft*, I thought the D.C. Circuit's example was a good one, in terms of the humility with which we need to approach these things. You may remember, the Court described the fact that there were tying cases brought when personal-computer manufacturers began to put hard drives into PCs as an integral part of the device. And so you didn't—for those of you who've been at it long enough—have to put the floppy disk in and out, right?—to do the word processing—

Well, at that time there were clearly two separate markets. It looked like maybe there was a pretty good tying claim. As time has gone on, that seems crazy. And I'm not sure we, as antitrust lawyers, are really best situated to figure out where product markets can go. And I don't have confidence that we're going to agree on what competition on the merits means if we intrude into it very deeply.

PROF. MURIS: I agree with all the qualifications, and let me give an overall gloss.

I come from the law and economics movement, and I'm much more comfortable talking about these problems the way Dennis, Carl, or even Steve Salop would, in terms of the way economists think.

We have problems, obviously, when we need to translate economics into rules that lawyers, judges, courts, and juries can use. But the phrase "competition on the merits" and the argument over what it means is a distraction, quite frankly.

COMMISSIONER JACOBSON: Let me try to distill what I think I have as a consensus here, which is, we don't view extension of monopoly from market A into market B as anticompetitive if it's associated with efficiencies that offset the net increase in price or reduction in output to consumers in the second market.

Would that be a principle that you could jump on board with?

Let me start with Professor Muris.

PROF. MURIS: You're assuming something that I didn't know was in evidence: that we have a demonstrated output restriction.

I do agree with Bob that you ought to try, at least in theory, to make those kinds of comparisons between the two markets.

It's much more straightforward to talk about output restriction and price increase, at least in concept, than to talk about whatever competition on the merits means. If that's what you mean, those are concepts that we can deal with.

COMMISSIONER JACOBSON: Mr. Pate?

MR. PATE: I'm on board with it in theory, but as a matter of fact, I don't think that an open-ended test of that type would mean it's going to work very well. And that's why, as you can tell from the testimony I submitted, I'm all about finding screens and safe harbors, which would allow businesses to know how they ought to behave.

And it's a perfectly valid criticism of my position that that is going to leave some theoretically anticompetitive conduct unredressed. But I think that it is a superior approach because it avoids chilling conduct that, at the end of the day, is going to look like a much faster computer that works with an internal hard drive.

COMMISSIONER JACOBSON: All right, let me go straight from there into an aspect of conduct that was resolved by a consent decree. And I think it's viewed as exclusive dealing, but equally can be characterized as what

Ken Glazer would call a vertical refusal to deal—that is, a restriction on the customers of the monopolist. And that's the per-processor license for the operating system that was utilized by Microsoft, which was blocked by the initial consent decree.

Now, as I understand the no-economic-sense, or profit-sacrifice test, that type of vertical refusal to deal, or exclusive dealing arrangement could not reasonably be characterized as a profit sacrifice, or as failing to make economic sense on its own—but at least in theory, it's capable of extending and enhancing monopoly power in a significant way.

Should we be applying the profit-sacrifice test? The no-economic-sense test in that kind of factual circumstance?

MR. PATE: I think it's an appropriate test to apply. I think, in terms of the *Microsoft* case and what was resolved, you need to look at the entirety of conduct there, and the entirety of the resolutions that were reached.

But I wouldn't take something like a per-processor licensing fee and then try to say we need an exception from the no-economic-sense test to govern that particular type of conduct.

With respect to that practice generally, if you look at levels, as I understand it, at which counterfeit, or non-purchased operating systems are used in certain parts of the world, it becomes clear that there may be some reasons that you would want to employ a per-computer licensing system.

PROF. SHAPIRO: I think I agree with what I take to be the thrust of your question, that the no-economic-sense test does not seem to work well in that case. At least that's my view.

The way I think of that is that Microsoft was imposing a cost on customers when they were buying, or potentially buying, from a competitor. And that raised their costs and prices, and it seems to me that would harm competition—without needing to get into the full facts of that situation.

I think that, in terms of imposing a cost on competitors, effectively—and so, first of all, I'm not sure we could call that a refusal to deal but—fine with me; you can call it what you want. But it does seem to indicate the no-economic-sense test makes no economic sense.

[Laughter.]

COMMISSIONER JACOBSON: On those facts—Professor Muris?

PROF. MURIS: I'm not a supporter of the no-economic-sense test across the board. Like many briefs from the two agencies, there were various passages written by one or the other. I do think the test was very appropriate in the context of the *Trinko* case. Many people agree that

Carl's distinction, between unilateral and conditional, is a very important one, and that unilateral refusals to deal—

PROF. SHAPIRO: Unconditional versus conditional?

PROF. MURIS: What did I say? Unilateral?

PROF. SHAPIRO: Unilateral—it's easy to do that.

PROF. MURIS: I'm sorry—unconditional versus conditional. The test comes up in the intellectual property area frequently as well. What we really have in the context of the *Trinko* case is something close to, empirically, the antitrust unicorn. Just like in predatory pricing, tough tests are appropriate.

This issue of what's a refusal to deal and what isn't can in some ways be almost metaphysical. I'm not sure, in the context that you're talking about, that the label makes—

COMMISSIONER JACOBSON: Let me clarify. And I don't think you were here for Ken Glazer's presentation, but this is an area where his distinction is particularly useful.

He characterizes horizontal refusals to deal as refusals to deal with direct competitors that impact the competitiveness of those direct competitors. And I would add editorially, I think that's the context which is *Trinko*, where the utility of the no-economic-sense test is at its highest.

That should be distinguished from vertical refusals to deal, or conditional refusals to deal with suppliers and customers that affect their patronage of rivals, and that may affect competition in the rival's market in a way that would be impaired by those conditional refusals to deal or exclusive dealing or similar arrangements.

PROF. MURIS: Let me say this in the abstract about the no-economic-sense test: Doug Melamed and Greg Werden, for example, have written a quite sensible defense of the test. When I read those, I said, well, this isn't your mother's no-economic-sense test, because it is quite nuanced.

I've always had a concern in the intellectual property area and in the *Noerr* cases—in those cases that were so important in my tenure in the government—that there can be a low but real potential of winning in court. Thus, the action would pass an economic sense test—sham litigation, for example, where the chances of winning are not zero. But if they're very low, I think sham litigation case makes sense to attack.

The response of the proponents of the no-economic-sense is to read sham out as an exception. Hew can articulate this much better than I can, but I think you can draft the test—and draft articles as those two gentlemen have—in ways that make the test much more defensible than its simple phrase seems to mean.

PROF. PITOFSKY: Just very briefly.

I'm not here to say that behavior by a monopolist that makes no economic sense is irrelevant in the examination of whether the behavior is competitive or anticompetitive. My quarrel is making that one factor dispositive. I don’t think that is appropriate.

I don’t know enough about per-processor fees to have an opinion. But if, in fact, it raises the cost to competitors of Microsoft, the fact that maybe there was some efficiency to Microsoft in doing it that way doesn’t seem to me to be dispositive; it should be a relevant factor.

MR. PATE: Yes, I think the comment on Tim’s point, and the classic example of throwing a match into the factory—you paid a penny for the match. In the context of the same patent application, there was a cost to it, and there’s no justification to that cost that isn’t related to the exclusion of competition.

I can imagine—well, the other thing I want to be clear about—let’s take a tie-out agreement of the type that was at issue in the *Microsoft* case, the more explicit one. It’s not my position that because that generated more money for Microsoft that therefore it made economic sense to engage in the activity, and the activity shouldn’t be punishable. That’s a caricature of the no-economic-sense test that I think has been the subject of some of the criticisms. I think as Tim says, Greg and Doug have done a very good job of explaining why those criticisms aren’t well taken.

COMMISSIONER JACOBSON: But in that context, aren’t you engaging in some of the balancing that Prof. Pitofsky is talking about, maybe not in looking at anticompetitive effects against procompetitive effects as such, but in the threshold aspect of the case in determining, in a much more complex setting, whether the conduct at issue can be characterized as making no economic sense?

MR. PATE: I guess. I wouldn't say that it's balancing of the type that he mentions, but there's going to have to be a decision about whether the benefit to the defendant was based on elimination of competition or based on something else. And we're probably going to be asking some of the same questions. I'll go with you that far.

COMMISSIONER JACOBSON: let me turn, in the remaining time, to bundling.

And Carl Shapiro indicated his support for the proposition I think most, if not all, of the prior panel assented to, which is that there should be a price-cost analysis of bundling, but it should be focused on the incremental costs with regard to the tied product, if you will, as opposed to the incremental revenues associated with the sales of that product.

And I am not sure where at least Professor Muris and Mr. Pate come out on that. Are we talking total cost or incremental?

PROF. MURIS: Well, I have trouble with that test. There's an Ordover-Willig article in the '80s about predatory pricing, where it was a quite sophisticated test that would be very hard to apply in practice. And it was that very test that Judge Breyer—now Justice Breyer—rejected in the *Barry Wright* case.

The Areeda-Turner test is very simple at one level, by using average variable cost as a proxy—maybe it's possible to do something simpler than what Ordover-Willig meant, but I would prefer a more straightforward application of Areeda-Turner ideas.

I understand the idea that if you're a monopolist, and you have ten other products, there could be a problem. But there obviously is a market check at some level as to what you can do. In any event, the second part of the *Brooke Group* test, in terms of recoupment and ultimate harm to consumers would be very important.

COMMISSIONER JACOBSON: I would be remiss in failing to point out that I think your views were misinterpreted, at least by certain people on the prior panel, who thought that you were also advocating incremental revenues versus incremental costs.

But if we're looking at total revenues versus total costs on the bundle, doesn't that effect make the bundling irrelevant?

PROF. MURIS: Obviously, the attributable cost is not a total-cost standard. Partly, I'm biased by the way the Ordover-Willig article was written. I asked Will Tom if that's what he had in mind, and he said no, but he hadn't read it for a long time. I'd ask Carl, if he remembers the article, if that's what he has in mind.

PROF. SHAPIRO: I vaguely remember the article. I'm fond of both authors. But it didn't really influence me, to tell you the truth. It seemed to me basic economic principles: what would price versus cost, in a meaningful way, mean in this context?

COMMISSIONER JACOBSON: My time has expired. Thank you all very much.

CHAIRPERSON GARZA: Commissioner Warden?

COMMISSIONER WARDEN: Thank you.

I have one introductory question for Carl.

You've talked about unconditional refusals to deal, that there would be terrible problems in determining price, if that were subjected to judicial scrutiny—am I right?

PROF. SHAPIRO: Yes.

COMMISSIONER WARDEN: How are those problems any worse, or any different, than those the courts face in reasonable royalty cases, where the buyer basically, if you will, has forced the seller to deal with him by infringing his patent, and then the price has to be fixed by the court?

PROF. SHAPIRO: I think reasonable royalties are very hard to determine for patents. They're usually idiosyncratic. The value is very hard to estimate. I think that's a difficult area. Some black art goes into that, as well. You know, we're kind of stuck with that in an after-the-fact infringement situation.

COMMISSIONER WARDEN: Okay. Thank you.

I want to be absolutely clear that I'm not in favor of required dealing, for a lot of reasons, only some of which are economic. I think there's a liberty interest at stake as well, even in the commercial area, in compelling people to deal with others.

Professor Pitofsky, you have, in both your written oral testimony, been very up-front about the uncertainty, unpredictability, and vagueness of the balancing test. I have thought for a long time that the Sherman Act, both Sections 1 and 2, have been saved from unconstitutional vagueness only by reason of a sort of a tripartite enforcement that has developed over the years, whereby the law is usually made in government cases seeking prospective injunctive relief, where the lack of notice is of less compelling consequence, and where criminal cases, of course, can be brought only by the enforcement authority of the United States. And there has been severe discipline in reserving criminal prosecutions for clear-cut cases, so that, whether or not they're clear-cut on their facts, there is a reasonable-doubt standard that has to be met, and the law is clear that if that standard is met as to these facts, the conduct was unlawful.

Somewhere in between lies the treble-damage action, which is not subject to the government screen, and which has a punitive, although non-criminal, element to it. Let me be clear: I don't accept the notion that single damages aren't single damages. That couldn't be any more true in this area of the law than in automobile accidents.

Would you, by reason of your acknowledgment of this vagueness issue, agree that treble damages shouldn't be available in any case where you have to go into this balancing test in order to find illegality?

PROF. PITOFSKY: I've said a number of times in the past that I think, rather than mandatory treble damages, discretion should be left with the judge. Maybe it's single damages, maybe it's triple damages. You might even think, in really hardcore, knowing violations, that the judge might assess more than treble damages.

But I think an automatic treble-damage award is not a necessary component of antitrust enforcement. And I agree with the things you said in introducing the question, and that is that it's probably a better thing for the law to be made by government enforcement looking toward injunctions and that kind of relief, as long as the government is there enforcing the law.

I believe the government has been enforcing the law for the last 25 years or so. And I have no quarrel with it. My only quarrel was that there was a period in the late 1980s when I didn't think the antitrust laws were being adequately enforced. I thought antitrust pretty much went to sleep. At that point, I think private actions kick in, and they're more important.

COMMISSIONER WARDEN: Well, you would agree, I take it, that the Constitution's committal of law enforcement authority to the Executive Branch doesn't vary according to the Executive Branch's enthusiasm for bringing antitrust cases.

PROF. PITOFSKY: I'm not sure I follow your question.

COMMISSIONER WARDEN: My time is up.

CHAIRPERSON GARZA: Commissioner Valentine?

COMMISSIONER VALENTINE: Nuts! Just when I thought we were getting agreement on a consumer-welfare standard and were focusing on competitive effects rather than on the business—since we actually had most of our last panel agreeing on that—I find two holdouts here.

So let me start with Mr. Pate and Mr. Muris.

Why do you think that, when the D.C. Circuit in the second *Microsoft* case and the Supreme Court in *Trinko* were presented with the opportunity to do a no-economic-sense test, they, in fact, declined to do so? And why shouldn't we take something from that?

MR. PATE: Well, I think it was consistent with the way the Supreme Court, at least, has always addressed antitrust cases, by leaving a great deal of vagueness in the law, and by being very careful about adopting bright-line rules.

I don't take anything particular from that. I think it would be well for different parties to continue advancing different rules that they think are appropriate. But I don't think there's any special message from the Court's not adopting a rule that wasn't necessary to reach a decision in that case. I wish they had, but I don't take any specific message from it.

PROF. MURIS: Both in *Microsoft* and *Trinko*, the Division has pushed that test. For me, you've got to distinguish what the sensible economics is and then, practically, how can you do it. The question of marginal costs versus average variable costs raises the point. Marginal costs, theoretically, is the right test, but average variable costs is, practically, a useful proxy.

There are people who've read *Trinko*—I think probably over-read—as coming awfully close to endorsing the no-economic-sense test. In unilateral refusals to deal, it made sense. But I think it's important to point out that the joint brief said that the general test sounds very much like whatProf. Pitofskyis advocating. It's not a balancing test in a rigorous sense, but it's sort of a grossly-disproportionate test.

You can certainly read the *Microsoft* opinion as almost saying that the restraint has to be naked—the restraints that had some sort of efficiency justification won in the *Microsoft* case. That's an extreme example of the balancing test. It is in some ways certainly consistent with the no-economic-sense test.

MR. PATE: The joint brief, of course, is at great pains to point out the dangers of an open-ended balancing test.

PROF. MURIS: Yes, absolutely.

MR. PATE: And I think what's talked about in the brief, if anything, is maybe closer to this gross-disproportionality concept that Professor Hovenkamp I think is most closely identified with.

PROF. MURIS: And it so cited him.

MR. PATE: Yes. And with respect to *Microsoft*, I think—not to get too far down in the weeds—we could debate whether, in that four-part analysis, we were doing balancing after it was determined that the conduct was anticompetitive in the first place. And I think that would be very different from saying that *Microsoft* adopts an open-ended balancing test, although some have tried to read it that way.

COMMISSIONER VALENTINE: Before I run out of time, I'm also somewhat intrigued by Carl's concepts of safe harbors. This isn't usually how Americans think about antitrust law. I think Europeans probably do more.

But he has suggested safe harbors for investment in new and superior production capacity, for unadorned product improvement, and for prices above incremental cost—although he then has the additional, slightly more complicated safe harbor for bundling, which I wish I could have in front of all of you, because if we could all just look at his last page I'd be interested in seeing if we could get agreement on some kind of concept of safe harbors to ensure that in what we might otherwise call unpredictable area of Section 2 we could get some certainty as to things that might well be legal.

And since I probably can't get you all a look at the last page of his testimony, maybe I'll ask you to try to buy in to some concept of a safe harbor for above-cost pricing in a bundling context, that we'll all work on refining—so long as we are very, very clear—and I understand, Tim, your concern here was that the safe harbor might become the final—this was the only thing that was going to be legal. But let's say we make it clear that this is clearly legal, and lots of other things may well be legal as well.

Now, assuming you could follow that question, does anyone think any other safe harbor should be added to Carl's safe harbors? And does anybody think that Carl's version of a safe harbor in the bundling context makes sense?

Shall we start with Carl?

PROF. SHAPIRO: Well, with the time—I've already—I'll leave it to the others.

COMMISSIONER VALENTINE: Okay.

PROF. PITOFSKY: Well, I just—maybe it will help if

I put this in a little context.

I think bundling, generally speaking, is a good thing. All I can think about is walking into a furniture store and they say, look, you can have the lamps, you can have the bed—

COMMISSIONER VALENTINE: It's a bedroom set.

PROF. PITOFSKY: Yes. If you take them all, I'll give you a ten-percent discount. How can we think that's anti-consumer? And therefore, any test that we adopt in this area should be simple.

I'm opposed to this test about putting an equally efficient rival out of business. How would you know that when you introduced a discount?

It should be simple, it should be easy to understand, and it should be very cautious about preventing sellers from, in my opinion, waging competition through bundling discounts.

MR. PATE: Well, you know I'm generally on board from having looked at my written testimony. I think the idea of safe harbors is a good one. I think that it's important to clarify, in the way you did. Tim's concern, I think, is a real one: that the safe harbor becomes the test.

I'm not sure I necessarily agree with Carl that incremental is the only safe harbor and, as I suggested, maybe some sort of total-cost comparison may end up being the only one that works, because if you only look at incremental, you're not taking account of the efficiencies of a larger firm that's able to offer this broad bundle of products at a lower price.

I understand there are theoretical ways in which a competitor in the single-product—in which a *LePage's*-type company is saying it's been harmed. I understand the theoretical possibility that in that product line there can be exclusion. But account needs to be made for efficiency of the larger firm.

PROF. MURIS: I'm a big fan of Carl's, and recommend repeatedly that people retain Carl. But I have to confess that I haven't studied these safe harbors. I do think a cost-based safe harbor is needed, and I've talked a few times now about that and about incremental. But Bob is clearly on the right track here about simplicity.

COMMISSIONER VALENTINE: Thanks.

CHAIRPERSON GARZA: Commissioner Shenefield?

COMMISSIONER SHENEFIELD: Thank you very much. Thank you, panel, for terrific written submissions.

My first question is to Mr. Pate. The speech that you cited, was that the Colonial Williamsburg speech? I have the feeling that I've seen that speech somewhere before. I may have even added a word or two to it. And that gives me the feeling that I'm—it's probably time to start doing something else.

MR. PATE: Well, I expect you, too, ought to be a supporter of the Gavil theory that it's really Lewis Powell who wrote these key decisions.

COMMISSIONER SHENEFIELD: Absolutely.

I'd like to descend from the sort of sunny uplands of theory, down to sort of the world of practical reality, along with John Warden and Hew Pate.

There has been a recommendation—I think from one of the people on the earlier panel—that if we could wave a wand and make Section 2 disappear, that would make the world better.

Does anybody on the panel agree with that?

PROF. MURIS: I heard this before, and I just want to disassociate myself from silence-means-consent to this whole line of questioning. And I sympathize, being on a commission like this on the tax panel which was supposed to end July 31st, and now it appears it will never end—

[Laughter.]

But that's my problem.

UNIDENTIFIED VOICE: [Inaudible.]

PROF. MURIS: Right. Right—like taxes.

I sympathize with where you're going, but I would have a more nuanced discussion.

I would not abolish Section 2, however.

COMMISSIONER SHENEFIELD: Okay—but just try my questions for the moment.

How many of you retaining Section 2 would want to confine prosecutions—or the cases brought—only to the government? Anybody?

[No response.]

No.

How many retaining Section 2, assuming you could get around the Seventh-Amendment issue, would be in favor of having those cases tried only to the court, rather than to the jury?

PROF. SHAPIRO: That intrigues me. I don’t have a definitive yes or no, but I’m concerned about the juries’ being able to really do a good job if the standards are so vague.

PROF. PITOFSKY: But there are simple monopoly cases and complicated monopoly cases. Most of them are complicated.

And I think it was Don Turner who once wrote that it would be better if all those cases could be assigned to the judge rather than to juries, which are out of their depth in terms of trying to deal with some of these issues.

MR. PATE: My guess is I’m going to have some sympathy for you right along the way. I don’t know if I would quite say, have only the government bring cases. But, as I suggested in a letter I sent to the Commission in January, along with Bob, with Professor Hovenkamp, and others—I think this question of having treble damages-driven litigation in Section 2 not only leads to chilling of conduct that is potentially procompetitive, in my view, but it also, in the cases where the government ought to intervene, is going to correctly make the government very hesitant to act, because it knows that anything it does can then be twisted and turned into a treble-damages suit somewhere else.

As to juries, I think these are not the type of questions that are the best-suited questions to having juries consider. That's a certainty.

PROF. MURIS: Let me just give my general views. Section 2 is obviously the most controversial area of substantive antitrust law. We need to have reforms, and I'm a strong believer in the common-law process, so it ought to happen that way.

If the courts in the '70s made decisions that would have seriously harmed the economy based on theories in the name of Section 2, then maybe some legislative relief would have been necessary. But we're certainly not there now, but with *3M* and what's happening in the lower courts with it, we have a situation I don't think anyone can be happy with in the standard-less nature of the *3M* decision.

COMMISSIONER SHENEFIELD: Thank you very much. Thank you, Madam Chair.

CHAIRPERSON GARZA: Commissioner Kempf?

COMMISSIONER KEMPF: I have a couple questions for Professor Muris on bundling.

When Commissioner Jacobson was asking questions, he said, well, what about the marginal-cost-revenue test? And then Prof. Pitofsky gave the furniture store example.

And you started off our proceedings today by saying, there're these studies that show that bundling—it's hard to find anyplace where it's ever bad. And we talked about safe harbors.

Are you prepared to go so far as to say, yes, we ought to have a per se rule that bundling is always fine?

PROF. MURIS: Although I praised Professors Carlton, Salop, and Shapiro, I gave a talk that I turned into a paper, where I criticized modern industrial organization economics for its tendency to tell you that any practice can be bad. It's sort of the Age of Aquarius economics—when the moon is in the seventh house, *et cetera*.

It's clear that bundling can exclude. Obviously, it can be an efficient practice and can exclude for that reason. Even though this experimental economics—it's not done yet—is much better than just abstract theory, it would be better if we could have even more empirical-type evidence. I don't think we know enough to say that we ought to have a per se rule in favor of bundling.

COMMISSIONER KEMPF: Second question on bundling.

Microsoft—at least it's my recollection, and John Warden would obviously know better—is that it began as essentially a bundling case, and then morphed into something different, broader, as time went by and other decisions were handed down. But in its first few weeks and months, a lot of the focus was on the bundling aspect of it.

And my question to you is, in its final configuration out of the D.C. Circuit, is there anything there that gives good or bad guidance in the bundling area?

PROF. MURIS: I'm not knowledgeable enough about *Microsoft* to know if that's how it really began. The whole idea of the technological tie was very important in various iterations of *Microsoft*, including the early consent agreement. Both Steve Williams' opinion and the final D.C. Circuit opinion were appropriate in rejecting those ideas. I don't think the concept has a lot to say about bundling.

I do think there's obviously a core of problems that the *Microsoft* case illustrated. I don't know the record, and there are two people here who know a lot more about *Microsoft* than I do, but to the extent that what Microsoft was trying to do was to stop an important form of competition—another platform, if you will—there was a very sensible core to the *Microsoft* case. That's a different issue than bundling.

I have a problem when people talk about mergers, unless you're in the middle of it and really look at the record. Otherwise, personally, it's very hard to know.

I look for a sensible theory with what looks like sensible evidence. That's certainly true in *Microsoft*. The D.C. Circuit's opinion—it was probably necessary to get all the votes—has so many unanswered questions.

COMMISSIONER KEMPF: Let me go to another question, but if anybody wants to, during the course of their answer, comment on my question on *Microsoft*, please do that.

And it's really for Professor Pitofsky.

You have thought about efficiencies since the '70s, when you were first on the Commission, and were probably one of the first to break with the—what I'll say—efficiencies are a bad thing—to thinking that maybe they're a good thing.

And my question really goes probably less to this panel than to the merger panel, but we've been discussing efficiencies, and I'd like to get your current thinking on that. And let me give you a couple specific aspects of it.

One is "passing on." And I will give you my own perspective, which is maybe different from yours, and this is that businessmen are the best people to decide whether it should be passed on, or—let me give you two examples—instead, used to make the plant more efficient; or paid out as a dividend to shareholders—and another word for shareholders is consumers.

And so, I've always been troubled by the pass-on aspect of it. And I know this is something you've thought about well, and for a long time. And any comments you would like to give, either on that or anything else having to do with efficiencies, I'd welcome.

One other thing I'd ask you to comment on. You referred to the *Philadelphia National Bank* earlier, when you were talking about efficiencies. I remember one discussion you and I had during a prominent case on the issue of efficiencies. And I said to you that if you brought that case your staff would trot out all those cases and reinforce bad law. And they did.

And so we have these continuing cases that, because the Supreme Court has not addressed *Philadelphia National Bank* since *Philadelphia National Bank*, we get the lower courts harkening back and, in effect, reinforcing the thinking of *Philadelphia National Bank* from time to time.

PROF. PITOFSKY: Well, just to show I have an open mind, I've changed my position several times on this passing-on point. I wrote, before I went in the government that I didn't think it was necessary to require passing on; that an efficiency is an efficiency.

That's not the way we wrote the Merger Guidelines, and I've come around to the view that the Merger Guidelines are the better idea, that at least in American antitrust law, it's not enough just to have an efficiency that goes into the pockets of the shareholders—that they become honorary consumers—but rather that the market structure should be such that the efficiency will be passed along to consumers.

I think that's better approach—although I regard it as an extremely close call.

COMMISSIONER JACOBSON: Let me just add that not all

Commissioners think the *Staples* case was wrongly decided.

PROF. PITOFSKY: Good.

COMMISSIONER KEMPF: I didn't say anything about it being wrongly decided. I was talking about a debate we had during the question of whether they were going to bring that case.

COMMISSIONER VALENTINE: And I noted that Bob probably hasn't changed his mind about bringing *Staples*, even if he has about efficiencies.

CHAIRPERSON GARZA: Okay.

COMMISSIONER KEMPF: By the way, it was wrongly decided.

[Laughter.]

COMMISSIONER JACOBSON: But not all Commissioners believe that.

PROF. MURIS: That's the kind of debate you guys have? Yes, it was; no, it wasn't?

[Laughter.]

You could strike that from the record, please.

[Laughter.]

COMMISSIONER JACOBSON: Only when we're at our intellectual finest.

CHAIRPERSON GARZA: All right.

The no-economic-sense test, at least in its simplistic form, has been criticized, both by people who are concerned it allows too much through, and people who are concerned that maybe it has the opposite effect. And it appears that perhaps its best use would be to help inform a broader balancing approach.

But if we wanted to—even if we could see that it's really difficult to conceive of a single standard that everybody can be satisfied with and that would cover all kinds of activity, do you think there's a value to—I think you probably said you do think there's a value to—perhaps adopting screens for specific types of behavior, that maybe there's an evolving consensus—can be wrongfully deterred? For example, bundling—coming up with some somewhat objectively applicable cost-price standard in the recoupment, along the lines of *Brooke Group*.

And then maybe if you could comment on Carl's suggestion of—I think what you were saying, Carl, was sort of a per se legality for what you call non-conditional refusal to deal, relegating the conditional refusal to deal to the current standards that apply to tying, exclusive dealing, and bundling.

Have I correctly characterized what your approach is on that?

PROF. SHAPIRO: Close enough—yes.

CHAIRPERSON GARZA: So I wonder whether you think there is value to taking an approach, if it was possible for us to influence and put that approach in place, of having these two different types of screens, or at least two different kinds of behavior: one bundling, and then one sort of the non-conditional refusal to deal.

MR. PATE: Yes—I think that the no-economic-sense test probably is not going to be the all-purpose resolver of every Section 2 question. But I think it's the closest anybody has come to trying to put a more objective face on Section 2 than we've had to date.

Yes, I'm a believer in screens that allow businesses to know when they can act without fear of antitrust liability. The Supreme Court is in favor of that. You can tell in the predatory pricing context—we already have it. I think we need to go there on bundling. I think any of these attribute all of the discount to the product where competition is alleged to be harmed—the *Ortho* test. There are a number of screens that would have resolved *LePage's* differently than it was resolved. Any of those would have been superior to the lack of any objective test there.

I think—yes, at the end of the day, I am probably with Carl, that if it is an unconditional refusal, even in the context where it's a cessation of activity— It's not clear to me why the law ought to say, if you find a better use for the resource, or you've chosen for some other reason to cease the conduct, that's going to provide the right benchmark. And so maybe the only time that we're going to— the best time, to me—if you reach a time where you need to have liability for an unconditional refusal to deal, you may be saying that you've found an area where utility rate-regulation is really what you need to put in place.

CHAIRPERSON GARZA: Professor Pitofsky, do you have any comment?

PROF. PITOFSKY: Yes, I think your question leads to a very constructive approach to the subject of this panel.

Let me take two extremes: a monopolist lies to the patent office; that should be per se illegal; there's no justification for that.

A monopolist charges a price above whatever the standard of cost turns out to be and drives everybody out of business. The monopolist is just more efficient; that should be per se legal.

In the end, I don't think there's going to be a single rule that's going to cover all of the behavior—tie-in sales, exclusive dealing, and on and on—under Section 2.

And I think what we ought to concentrate on is a series of rules that address each of these forms of behavior, and decide if they're per se legal, illegal, or in a gray area. If they are in a gray area, what are the factors that we ought to look at?

PROF. SHAPIRO: If I could just quickly add something.

I really like the way you put it, that the no-economic-sense test can help inform a broader balancing. I'm really there.

I think the most general statement I could say—and I could give also examples where no-economic-sense kind of leads us astray. And I said that in a cute way before, but I don't really mean we can't use it at all; we just have to use it in a bigger, broader context.

The question I always ask, and this applies to all antitrust, why did the company engage in the conduct that it's doing? I want to know that, whether it's a merger, whether it's an alleged tying—why are they doing it?

If it's a price below cost, you say, well, why are you doing that? Why are you selling your product below cost? I'd like to know. The answer could be, I want to drive the competitors out, not that you're likely to hear that directly, or it could be, well, I'm building up good will. So that's the starting point.

And I think the no-economic-sense test says you're doing something that doesn't look like it makes any economic sense. It raises the question, why are you doing it?

So, not as the only screen, but as a helpful frame in the broader balancing.

CHAIRPERSON GARZA: Tim, do you have any comment?

PROF. MURIS: Yes. In the hands of Carl, Dennis, or other economists, why would you do it is an excellent question. The problem is, in the hands of the jury, with extraneous documents from this salesman, or that mid-level executive, you can have problems. Carl understands that perfectly.

Obviously, you want a rationale. But it’s so easy that that blends into intent, and that causes real problems. We have to be very careful about that problem.

PROF. SHAPIRO: Agreed.

CHAIRPERSON GARZA: Commissioner Carlton?

COMMISSIONER CARLTON: Thank you.

First I’d like to ask Bob—would you generally support the notion that you would not compel a firm to deal with a rival who wants to compete downstream with it, assuming the firm is a monopolist, if the rival has never dealt with anyone ever before?

PROF. PITOFSKY: Even without the last clause, the answer is yes, I would generally support the view that you don’t have to deal with anybody if you don’t want to. But there are very rare exceptions.

COMMISSIONER CARLTON: Yes. So—

PROF. PITOFSKY: A student wrote a paper for me once: suppose one company obtained the only patent on stem cell research and wouldn’t make it available to anybody else? How do we feel about that? Now it turns out the party that has the patent on stem cell research makes it available to everybody. But assume otherwise. Do we really want a situation in which nobody else can engage in stem cell research except the one company, in order to protect its incentives to innovate in the first place?

I think maybe that ought to be an exception.

MR. PATE: But, Bob, that assumes antitrust law is the only thing that would deal with it. If you state such an extreme case, the government can seize a patent and pay just compensation for it. There may be some things we just socially won't tolerate.

But antitrust law has to make a general rule, not just for that exceptional case.

PROF. PITOFSKY: Excellent point.

COMMISSIONER WARDEN: I agree with Hew. I don't think that's an antitrust issue at all, frankly. I think it's a much worse issue.

COMMISSIONER CARLTON: Hew, I generally liked your statement, and the conservative nature of it sort of resonates with me, but I'm worried about the no-economic-sense test, illustrated by some of the questions I asked before on the first panel.

And what I'm worried about is, aren't you concerned that it could easily be turned into a test in which it's a fishing expedition for an economist to show that a level of activity—like advertising—is excessive, and that had you not advertised so much, for example, your rival would have survived? And wouldn't that have been better? And then you'll get an economist saying, yes, the advertising's good, but this firm went too far. That's a complicated study—spending five year's doing it. And this guy went too far.

That’s what I’m worried about, about the no-economic-sense test. That it’s an activity level that’s being discussed, not a yes or no, should you engage in the activity. And if it’s an activity level, you’re raising the question, are you doing too much advertising? Are you doing too little? Are you doing too much innovation? Too little?

It seems to me a very dangerous area.

I’m not saying that there aren’t other areas where it’s useful. But if that were the test that a court had, it seems to me, in the hands of a jury, or someone not schooled in sort of the right methods, it could be dangerous.

MR. PATE: Well, I think you’re right to be concerned, and maybe—I remember going back to specifically put a sentence in the testimony to reiterate: I see it as a screen, not a test for liability. And maybe I need to go put more sentences in.

But there are all sorts of reasons you can do things that in hindsight don’t end up making economic sense. Maybe we advertised too much, or maybe we made a wrong guess as to how many consumers were going to get on the added airline capacity we put on the route. Or maybe we’ve pursued a loss-leader sort of strategy.

So I think it’s important to see it as a screen. I agree that there are problems of implementation with it. I agree that, in an academic way, Carl clearly can point out ways in which it doesn’t elegantly solve every problem.

I just am at a loss to identify a test that, on balance, is superior as a general way of trying to inform Section 2 cases.

COMMISSIONER CARLTON: That's actually a good segue to my next question, which is really for Tim and Carl, on bundling.

And I wanted to make it clear that my understanding of what you're saying is, a price-versus-cost test, whether it's total price, or it's total cost, or total variable cost or incremental-revenue-versus-incremental cost—that's a safe harbor. As *Brooke Group* makes clear, or as I read it, it's not just where the price is below cost, but also it's other elements: if someone's alleging exclusionary behavior, that there could be a recoupment period—that is, your behavior's going to change.

So, I assume both of you would be on board with a test that said, even if you don't pass, for some reason, this cost test, if there's no possibility of recoupment and that's what's being alleged, that—

PROF. MURIS: Yes, I mean *Brooke Group* in both parts.

COMMISSIONER CARLTON: Carl?

PROF. SHAPIRO: I absolutely mean it that way in the safe harbor. I'd just refer you to the last three or four sentences in my statement. It's exactly what you just said: you'd still have to show how widely was it used? Is there a danger of really monopolizing? Can you recoup? It's those other elements that would be part of *Brooke Group*, too.

COMMISSIONER CARLTON: Right.

For example, suppose you had, and a lot of people do this—they say, buy one, get one free. Stay three nights, and the fourth night is free. That would look like it fails an incremental-revenue-versus-incremental-cost test. But, viewed properly, it may just be a marketing device. And I assume you wouldn't object to that.

PROF. SHAPIRO: No, not at all. And I have to refer to the footnote—

[Laughter.]

—I'm sorry about that.

But I think it's a key point, which is, buy one-get one free. It's not—they don't usually say—after you sign up for three nights, they don't say, oh, by the way, now that you're here we're going to give you another night for free hoping you won't go across the street to the competitor. No, it's part of a package to get you to take the three in the first place.

COMMISSIONER CARLTON: Right.

PROF. SHAPIRO: So, in other words, we can't assume that the customer would have taken the three without that. So you have to be careful about that. And if you're increasing the probability of a sale at all, you'd have to consider the potential, the probability that you would have made the sale without the offer.

So, there are some subtleties. I think conceptually, it's the right thing to do.

I acknowledge it's got problems, but then you can't meet the safe harbor, and it throws back to the plaintiff—the plaintiff would have to show you were pricing below cost. In that case it would be difficult for them.

COMMISSIONER CARLTON: And properly interpreted, it's actually very subtle, because, as you say, you're going to be sorting customers in ways different than prior to having the bundling, and therefore, the customers who don't take the bundle will be buying something else. And to the extent you're changing the number of customers staying different numbers of nights, your incremental revenue is not just on the assumption that someone's buying a bundle, because it's altering consumer behavior towards all other bundles—to all other products that the firm may be offering.

So I think, properly interpreted, it can be a very subtle test.

PROF. SHAPIRO: Well, I agree with that, Dennis. And I think—let me put it this way: I cast this in terms of a safe harbor, but another way to view it is, what does the plaintiff have to show? What's the burden for the plaintiff here? And the plaintiff, I would think, would have to show there was some element of pricing below cost, which could be a significant hurdle, actually, for the reasons we're talking about.

And I guess I recognize that might lead to some false negatives, but I think discipline here is needed for the practical problems we've talked about, and I'm willing to live with that.

PROF. MURIS: This is part of the reason I have some hesitation, and referred back to the Ordover-Willig article. The more nuanced and complex you make it, the less useful it's going to be for businesses day to day.

COMMISSIONER CARLTON: I agree with that.

And although I'm out of my time, Makan ceded his time to me.

[Laughter.]

So I just have one final question.

Actually, I was intrigued when Bob was talking about the consumer-welfare standard. And I just have a simple question.

I understand that if it goes in the pocket of the supplier you don't want to count it. But isn't that a little hard to square with the fact that a lot of markets that we look at are markets in which the consumers are corporations, and we are quite concerned with—regardless of how the consumers as corporations then deal downstream, we are interested in protecting them?

So it always seems to me an odd asymmetry to say that if it's a production efficiency, even if they keep it, we don't care. But when we're doing mergers, and customers of the merging firms are corporations, then we are concerned with the welfare of corporations. It just seems a bit inconsistent.

PROF. PITOFSKY: Neat question. I'll have to go back and think about the Merger Guidelines.

I suppose one possibility is that that wouldn't count as an efficiency unless you thought the corporation downstream would also pass it on to consumers.

COMMISSIONER CARLTON: Yes. Yes.

PROF. PITOFSKY: That would be—that may have been what we had in mind. Who knows?

[Laughter.]

CHAIRPERSON GARZA: Commissioner Yarowsky?

VICE CHAIR YAROWSKY: Yes. I have a question for Professor Muris, and it really goes to the effect on innovation in certain bundling situations.

One of the great things I think you did here was to really have that whole health care antitrust working group and task force. One of the issues—and I just want everyone to know, I did follow it in terms of the legislative thing on the Hill. So I want to let folks know that.

But this is more generic. You were looking at group purchasing organizations, in part. So what you had was some companies filing through a group purchasing organization, and there are two or three dominant group purchasing organization and acute-care hospitals—and certain companies could bundle products. They could bundle commodities, sutures, and band-aids. But they could also bundle it with very sophisticated, high-tech equipment.

Now, you had other smaller companies that couldn’t do that, obviously. They made some very amazing high-tech equipment, but that was the only product they had, or they only had two or three products, and they wanted to compete through the group purchasing. So there was some buying power, obviously, in the GPO.

In addition, there were certain attributes that you all looked at, which is that there were a number of long-term exclusive contracts that were set up in that system, which reinforced whoever got the contract to have it. And if it was a long-term contract, and the generational change in those industries are very quick. I mean, they’re about 18 months. If you had a seven-year contract, you’d kind of walk in, freeze, at least for that time, the choice of that equipment.

Now, if you pooled these kind of low-tech commodities with these very high-tech, refined commodities—products—that change very quickly, and locked it into a bundle, you might, because of that fact alone, exclude the ability of certain competitors to compete to get their product into the system. That could affect not just the hospitals, but obviously the patient care, if there was a better product that couldn't penetrate the access point.

So, that's just one situation, and it's rather convoluted. But it happens, and you all looked at it.

Is that a factor we should bear in mind and not be too completely glib about bundling?

PROF. MURIS: I've got to be careful here, because both Joel Klein and I, while Chairman, had investigations. That much is public.

VICE CHAIR YAROWSKY: Okay. Maybe we can make this more generic.

PROF. MURIS: I'll just say a little bit about the GPOs, because there are some interesting facts that are public. We talked about it in our report. There are two interesting papers that the two sides hired: from Herb Hovenkamp and Einer Elhauge. And Einer's argument, I thought, was quite strained.

Let me generalize to the literature on bundling. There are some aspects that even the advocates of attacking bundling say could prevent a problem and may apply in the GPO situation. Telecom provides another illustration where you have bundle versus bundle competition. Professor Nalebuff, for example, will tell you, that's the best kind of competition. You have large firms that can bundle, plus some of the smaller ones can get together and bundle themselves. One issue is with the smaller firms—it's true with smaller inventors, for example. We did a patent report, and there's a whole small-invention community that faces difficulty in exploiting its inventions and often feels that it has to sell too cheaply to the bigger firm, who are better at marketing and exploiting inventions.

In any event, if you look at this theoretical literature that criticizes bundling, there are attributes of markets to which even that theoretical literature does not apply.

VICE CHAIR YAROWSKY: I was going to also just ask your comments, Professor Pitofsky, just because of the telecom aspect.

PROF. PITOFSKY: Yes—when we talk about bundling, we're saying you can have A at a price, you can have B at a price, and you can have C at a price. But if you take all three, I'm going to give you discount.

My reaction to the issue that you've raised—and I don't mean to be too casual about the possibility of this having an anticompetitive effect on a small rival selling only C, is that you allocate the discount. And the small rival really only has to meet that portion of the discount that applies to the third product, or the fifth product, or the tenth product.

Are there going to be situations in which small rivals are considerably disadvantaged by full-line companies? Yes. On the other hand, a solution that makes bundling highly difficult to introduce, I think, would be—that's a balance you have to strike, and I would like to avoid striking a balance that pretty much eliminates or diminishes the ability to bundle.

VICE CHAIR YAROWSKY: But does the buying-power end of this kind of accentuate the potential problem?

PROF. PITOFSKY: The buying power?

VICE CHAIR YAROWSKY: In this example that I gave—as I say, there weren't many buyers of these products. They were all funneled through an area where the market—there were literally two buyers in the country that affected 85 percent of all the hospitals.

So if you had that situation—there weren't many other opportunities—either pair up and bundle if you lost that bid, or not.

And so those are situations where, if you had a freer market at all levels, you wouldn't have the problem. But it was a fairly constricted market.

PROF. PITOFSKY: I certainly think if the manufacturer of C didn't have to go through those two funnels, and could go around them to get to customers, then that diminishes the problem. If, in fact, you can only go through these two funnels, yes, that makes it more dangerous in terms of the elimination of the smaller, non-full-line company.

PROF. SHAPIRO: Can I just comment?

First off, if you have a really good catheter, and it's the best one, those GPOs don't really want to get stuck with an exclusive arrangement to buy that catheter if another one's coming out in a year, and not let their hospitals—so, there's some buyer, however big it is, with some incentives not to make a mistake that way. And their member hospitals sometimes retain the right to go outside the GPO.

So there's an issue there that doesn't have anything to do with bundling—just, can the incumbent catheter guy knock out the next better one?

If they're making the sutures available for free, I'd say, how's that different than a discount on a catheter? I don't know. If the suture is just a competitively-available thing, it sounds like money rather than—unless we've got monopoly sutures. But maybe that's not going to happen.

So we get into these details, and I'm not sure—there's a number of different elements that you've woven in there, and some ability, I think, for people to protect themselves, including the GPOs to protect their own interests—

CHAIRPERSON GARZA: Commissioner Litvack?

COMMISSIONER LITVACK: Thank you. I'm satisfied with the testimony so far, and so I'll pass. I have nothing to add.

CHAIRPERSON GARZA: I'm sure you've made some panelists happy.

Commissioner Cannon.

COMMISSIONER CANNON: It seems like a trend here.

I'll tell you, this has been a terrific afternoon—I think back and forth—Hew said in the beginning what Sandy said, probably in the panel before this, which is, a lot of us who have been in a corporate setting—everybody really at this table and a lot of folks in this room—always will end up counseling our clients. And I'm sitting here thinking, okay, what do we do of value here as a Commission?

I think the odds of—as we talked about with Rick earlier today, the odds of any sort of legislative clarification or fix is really kind of hard to fathom at this point.

COMMISSIONER VALENTINE: Zero.

COMMISSIONER CANNON: Okay. Zero, perhaps less.

[Laughter.]

Who knows?

But that's what I'm really interested in. Because, as a practical matter, what really happens is, as Sandy says, someone doesn't come into your office, or you don't go to an executive committee meeting of a company, and a question like this gets raised, and someone says, well, let me just go check with a team of economists we have, and then we will do an opinion, and we'll get back to you in a couple of months. It's gone at that point.

Decisions just get made—I don't want to say "on the fly"—that's inappropriate, but they get made very quickly. And what your clients usually want is—they've dealt enough with lawyers to know there's no certainty in the world here. They look for percentages. And they know that if they kind of guess wrong, they'll end up—someone's going to sue them for something, and then we have to kind of sort it out.

So I'm just looking here, kind of as a wrap-up question, what does this Commission do? How do we do something to give some sort of clarity, or some little better comfort in this area? Of all the things we're probably going to talk about in the next few months—yeah, this is just one of the thorniest areas there are. And it's also one that gives, I think, a lot of people pause: are the antitrust laws actually doing what we think they're doing, pursuant—and in exclusionary conduct cases—or are they having the opposite effect?

So that's kind of an open-ended question.

Hew, can you take a stab at that?

MR. PATE: Well, I assume you're thinking about a report. And if you wanted to do something of practical value, you could at least report that it looks like every single witness, despite a number of differences, has agreed that *LePage's* is a terrible event in the law, and that courts need to apply some objective standard.

And I think if you report that, it may be helpful to not having courts develop the law in an unfortunate direction.

COMMISSIONER CANNON: Tim?

PROF. MURIS: This may be beyond what you're asking for, but I spend a lot of time in my life thinking about how to get five people to agree, and now I've got nine people on the Tax Panel. One of the things I was amazed about my chairmanship is that we had more unanimity even than Bob, and Bob had almost virtual unanimity.

Quite frankly, I applied a criteria—I'm going to talk about the substance in a second—that if somebody really cared strongly about something, and I didn't, there's a log-rolling process that can occur and can lead you to say a lot that way. Of course, it could be complex.

On the substance, I think you go in baby steps and see if the baby steps add up. The point that Hew made about *LePage's*, for example. The next step is, do you agree on a cost-based test? At least as a safe harbor? Then can you say something about the cost? Maybe you can; maybe you can't. From hearing some of your questions, you start to slip there.

But if you divide it into these little baby steps —we're doing this in the Tax Commission—you'd be surprised at what you can accomplish.

COMMISSIONER CANNON: Bob?

PROF. PITOFSKY: I don't know that I'm going to add anything to what's just been said.

There's no legislative fix here. There will be a report. I think the report should emphasize areas where the law seems to be going in the right direction, and that's true of all circuits but one with respect to bundling.

And with respect to the one circuit, point out what the flaws are in its approach, and perhaps influence the Supreme Court to take a case to straighten out this area.

The Department and the FTC have been very lively about participating in the cert. process, and amicus process. And I think this group should compliment them for doing that, and tell them to keep it up.

COMMISSIONER CANNON: Carl?

PROF. SHAPIRO: Well, I think you have a chance to make an authoritative statement. I try to make them all the time, but they're not viewed that way.

[Laughter.]

So, *LePage's*—you've heard a chorus.

And the refusals-to-deal area—maybe, again, it's a baby step to talk about unconditional ones, so you're not taking on too much. And there's, I think, a pretty good consensus that that's an area maybe where some clarity—and maybe it's through jury instructions, to influence that process, or just what the clerks will read; I don't know.

But if you can make an authoritative statement there, I think it could help. And try not to do too much, because then it gets controversial.

COMMISSIONER CANNON: Yes, and that gets back to our whole question—debate—today of trying to get to the heart of all this in terms of the substance versus the around-the-edges procedural things, like juries not having this, or single damages versus treble.

Thanks. Terrific. Thanks very much. Really appreciate it.

CHAIRPERSON GARZA: On behalf of the Commission, I'd like to thank all of the panelists for your time, for your thoughtfulness, and for your comments—and for putting up with our questions this afternoon.

Thank you.

[Applause.]

[Whereupon, at 4:50 p.m., the hearing concluded.]