MEMORANDUM

From: AMC Staff[†]

To: Commissioners

Date: July 11, 2006

Re: Exclusionary Conduct Discussion Memorandum

The Commission adopted the following question for study: "Should the substantive standards for determining whether conduct is exclusionary or anticompetitive under either Section 1 or Section 2 be revisited?" The Commission focused its study of this question on two specific areas that have given rise recently to substantial litigation and lingering judicial uncertainty: refusals to deal (and the related essential facilities doctrine) and bundling and loyalty discounts. On May 19, 2005, the Commission requested comments on the following questions.

1. What are the circumstances in which a firm's refusal to deal with (or discrimination against) rivals in adjacent markets violates Section 2 of the Sherman Act? Does the Supreme Court's decision in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), state an appropriate legal standard in this respect?
2. Should the essential facilities doctrine constitute an independent basis of liability for single-firm conduct under Section 2 of the Sherman Act?
3. What should be the standards for determining when a firm's product bundling or bundled pricing violates Section 2 of the Sherman Act?

[†] This memorandum summarizes comments and testimony received by the AMC to assist Commissioners in preparing for deliberations. All Commissioners have been provided with copies of comments and hearing transcripts, which provide the full and complete positions and statements of witnesses and commenters.

4. How should the standards for exclusionary or anticompetitive conduct be determined (*e.g.*, through legislation, judicial development, *amicus* efforts by DOJ and FTC), particularly if you believe the current standards are not appropriate or clear?[1]

In addition, the Commission considered a related issue within the context of the "new economy." The Commission sought comment on the following new economy issue that relates to exclusionary conduct:

1. Should there be a presumption of market power in tying cases when there is a patent or copyright? What significance should be attached to the existence of a patent or copyright in assessing market power in tying cases and in other contexts?[2]

The Commission held a hearing on the exclusionary conduct issues, consisting of two panels of witnesses, on September 29, 2005 (both panels addressed all exclusionary conduct topics). The first panel included Kenneth L. Glazer, then Chief Competition Counsel for Coca-Cola Co. (now Deputy Director, Bureau of Competition, Federal Trade Commission ("FTC")); M. Laurence Popofsky, Heller Ehrman; Charles F. (Rick) Rule, Fried, Frank, Harris, Shriver, and Jacobson LLP (formerly U.S. Department Justice Department ("DOJ") Antitrust Division, Acting and Assistant Attorney General ("AAG") for Antitrust 1985-89 and Deputy AAG 1982-1985); Steven C. Salop, Professor of Economics and Law at Georgetown University Law Center; and Willard K. Tom, Morgan, Lewis & Bockius LLP (formerly Deputy Director, FTC Bureau of Competition 1998-2000). The second panel included Timothy J. Muris, O'Melveny and Myers LLP (formerly FTC Chairman 2001-2004 and Director, Bureau of Competition 1983-1985; R. Hewitt Pate, Hunton & Williams LLP (formerly DOJ Antitrust Division AAG, 2003-2005 and Deputy AAG 2001-2003); Robert Pitofsky, Joseph and Madeline Sheehy Professor of Antitrust

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1 70 Fed. Reg. 28,902, 28,904 (May 19, 2005).

2 *Id.* at 28,906.

and Trade Regulation Law at Georgetown University Law Center and Arnold & Porter LLP (formerly FTC Chairman 1995-2001 and Commissioner 1978-1981); and Carl Shapiro, Transamerica Professor of Business Strategy, Haas School of Business, and Director, Institute of Business and Economic Research, University of California at Berkeley (formerly DOJ Antitrust Division Deputy AAG for Economics 1995-96).[3] In addition, panelists at the New Economy hearing on November 8, 2005, and the Economists' Roundtable on January 19, 2006, addressed certain of the new economy issues relating to exclusionary conduct.[4]

The Commission received written comments from several members of the public addressing exclusionary conduct.[5]

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3 Unless otherwise noted, all references to "Trans." are to the transcript of the hearing on September 29, 2005.

4 *See* Mergers-Substantive Issues Discussion Memorandum, at 4-5 (June 14, 2006) (listing panelists for these hearings).

5 Comments of the American Antitrust Institute Working Group on Exclusionary Conduct (July 15, 2005) ("AAI Comments"); Comments of CompTel/ALTS to the Antitrust Modernization Commission (July 15, 2005) ("CompTel Comments"); Timothy J. Muris on Behalf of the United States Telecom Association, Comments on Antitrust Law, Economics, and Bundled Discounts (July 15, 2005) ("Muris Statement"); A. Douglas Melamed, on Behalf of the United States Telecom Association, Comments on Refusals to Deal and the Essential Facilities Doctrine (July 15, 2005) ("USTA Comments"); Comments on the Western Coal Traffic League on Railroad Antitrust Issues (July 15, 2005) ("Western Coal Comments"); International Bar Association Antitrust Committee, Exclusionary Conduct Comments (July 15, 2005) ("IBA Comments"); International Chamber of Commerce, Comments on Selected Issues for Study (Sept. 5, 2005) ("ICC Comments"); Steven C. Salop, Question: What is the Real and Proper Antitrust Welfare Standard? Answer: The *True* Consumer Welfare Standard (Nov. 4, 2005 ("Salop Comments"); Business Roundtable, Comments Regarding the Issues Selected for Study (Nov. 4, 2005) ("Business Roundtable Comments"); Chamber of Commerce of the United States of America, Comments on Commission Issues Accepted for Study (Nov. 8, 2005) ("Chamber of Commerce Comments"); Robert E. Bloch, A Comparative Analysis of Art. 82 of the EC Treaty and Sec. 2 of the Sherman Act (Feb. 1, 2006); ABA Antitrust Section, Comments Regarding Exclusionary Conduct Standards (Mar. 17, 2006) ("ABA Comments").

I. Background

Section 2 of the Sherman Act forbids "monopolization" and "attempted monopolization" (as well as combinations and conspiracies to monopolize) of any part of the trade or commerce of the United States.[6] As discussed further below, proof of exclusionary or anticompetitive conduct is an essential element of both monopolization and attempts to monopolize.[7]

Section 2's prohibition against monopolization requires courts to determine whether a defendant has illegally obtained or maintained monopoly power—that is, the power to control prices or exclude competition—within a relevant market.[8] The classic statement of unlawful monopolization is found in *United States v. Grinnell Corp.*:

> The offense of monopoly under § 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market; and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acquirer, or historic accident.[9]

Monopoly power can be proven by direct evidence of the actual exercise of control over price or exclusion of competition within a relevant market, or by indirect evidence, such as

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6 *See* 15 U.S.C. § 2.

7 *See Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (2004); *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1990). Conduct that violates Section 2 of the Sherman Act may also violate Section 1 of the Sherman Act, which prohibits agreements that unreasonably restrain trade. Of course, not all conduct that violates Section 1 violates Section 2, and conduct sufficient to support a violation of Section 2 need not independently violate Section 1. *See, e.g., United States v. Dentsply International, Inc.*, 399 F.3d 181, 186 (3d Cir. 2005) (holding exclusive dealing arrangement violated Section 2 while not considering unappealed rejection of Section 1 claim). Consistent with the Commission's focus, this memorandum addresses the standards applicable to unilateral refusals to deal and bundling specifically challenged under Section 2 of the Sherman Act.

8 *See Eastman Kodak v. Image Technical Services*, 504 U.S. 451, 481 (1992) (offense of actual monopolization requires proof of monopoly power in relevant market); *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (monopoly power is the power to control market prices or exclude competition).

market share and the prospect of entry into the market (or expansion) by potential (or existing) rivals.[10]

Significantly, Section 2 does not forbid monopoly as such (as opposed to its willful acquisition or maintenance by unlawful means), including the charging of a monopoly price.[11] Although a rule prohibiting monopoly pricing could increase welfare in the short run, it potentially places courts in the position of acting like a price regulator. Accordingly, it is argued that such a rule may reduce welfare in the longer run, by depriving firms of the incentive and ability to adopt efficient organizational forms and production processes and to introduce new products.[12]

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[9] 384 U.S. 563, 570-71 (1966).

[10] *See United States v. Syufy*, 903 F.2d 659 (9th Cir. 1989) (ease of entry dooms monopolization claim); *United States v. Microsoft Corp.*, 253 F.3d 34, 41 (D.C. Cir. 2001) (monopolization claim supported by direct evidence that a firm can raise prices substantially above a competitive level in a relevant market); *Tolerate Sys. v. Caro*, 689 F. Supp. 221 (S.D.N.Y. 1988) (discussing Areeda and Turner discussion of direct economic proof of monopoly power); *United States v. Aluminum Co. of America*, 148 F.2d 416, 424 (2d Cir. 1945) (market share screen); *duPont*, 351 U.S. at 391 (control of 75 percent of market sales would establish monopoly power).

[11] *See Trinko*, 540 U.S. 398; *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985); *United States v. International Harvester Co.*, 274 U.S. 693, 708 (1927) (Section 2 does not make mere size an offense); *United States v. United Shoe Machinery Co.*, 247 U.S. 32 (1918) (same); *American Tobacco Co. v. United States*, 221 U.S. 106 (1911) (same); *Standard Oil Co. v. United States*, 221 U.S. 1, 62 (1911) (Sherman Act does not forbid "monopoly in the concrete").

[12] *See* Shapiro Statement, at 3 ("Both legitimate competition and exclusionary conduct harm *competitors*, so observing that a given tactic harms competitors typically is not helpful in determining whether that tactic constitutes exclusionary conduct or legitimate business competition."); *see also Standard Oil Co.*, 221 U.S. at 62 ("The omission of any direct prohibition against monopoly in the concrete . . . indicates a consciousness that the freedom of the individual right to contract when not unduly or improperly exercised was the most efficient means for the prevention of monopoly.").

In addition, the sole fact that the conduct of a monopolist may exclude or disadvantage rivals does not in and of itself constitute unlawful monopolization.[13] Instead, the Sherman Act forbids "predatory" or "exclusionary" conduct aimed at acquiring or maintaining such power.[14] Thus, a firm may acquire or perpetuate monopoly power by realizing efficiencies not realized by rivals, even if the ultimate result is output that is lower and prices that are higher but for the conduct in question.[15] Because U.S. antitrust law promotes competition, and does not protect competitors *per se,* courts do not attempt to balance the benefits of efficiencies gained through

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13 *See American Tobacco*, 221 U.S. at 178-80; *United Shoe Machinery Co.*, 247 U.S. at 63-64. The general rule against banning monopoly in and of itself (or even all conduct that disadvantages a monopolist's rivals) rests on an assumption that such bans would reduce the welfare of consumers and the rest of society. *See Brooke Group v. Brown and Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) (The Sherman Act protects "competition," and not individual rivals); *see also* Shapiro Statement, at 3 ("a firm that offers high-quality products at a low price may 'exclude' competition or 'foreclose' its competitors. Of course, antitrust law welcomes this behavior."); Trans. at 159 (Pitofsky) ("[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."); Herbert Hovenkamp, *Federal Antitrust Policy,* 553 (2d ed. 1999) ("Nothing is a more effective barrier to entry than a firm's capacity to produce a high quality product at a low price, or to provide improved service to consumers."); Alan J. Meese, *Monopolization, Exclusion, and the Theory of the Firm*, 89 Minn. L. Rev. 743, 834-35 (2005) ("Meese, *Monopolization*").

14 *See Aspen Skiing*, 472 U.S. 585; *United States v. Grinnell Corp.* 384 U.S. 563 (1966); *American Tobacco*, 221 U.S. at 178-81 (Section 2 does not bar normal and usual contracts entered by a monopolist); *Eastman Kodak*, 504 U.S. at 483-86 (conduct supported by legitimate business justification does not offend Section 2); *United States v. United Shoe Machinery Co.*, 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 ("competition based on pure merit" cannot offend Section 2, even if it fortifies a monopoly).

15 Lawrence Sullivan and Warren Grimes, *Antitrust Law: An Integrated Handbook*, 73 (2000) ("Sullivan & Grimes, *Handbook*"); *see also* Thomas A. Piraino, Jr., *Identifying Monopolists' Illegal Conduct Under The Sherman Act*, 75 N.Y.U. L. Rev. 809, 824-25 (2000) ("To punish a firm simply because it has achieved a monopoly is to discourage superior business performance."); Meese, *Monopolization,* at 834-35.

superior performance (rather than predatory conduct) against short term effects on price or output resulting from impact on less efficient rivals.[16]

As explained by Professors Lawrence Sullivan and Warren Grimes, Section 2 jurisprudence reflects

> a uniquely American, market-affirming response to power: to end dominance when attained in unapproved ways, yet to give dominance wide latitude when it is inevitable or earned by merit. The response assumes that strong incentives promote efficiency, and that power, unless bolstered either by unfairly aggressive conduct or by government support, will erode under the pressure of market developments. Moreover, where supra competitive pricing accompanies power, erosion of the power is thought to be more likely because high prices signal the need and promise a reward for entry.[17]

Of course, conduct that reduces the sales of a firm's rivals does not announce itself as "efficient" or "inefficient. Moreover, forms of conduct that may be efficient for some firms in some contexts may constitute inefficient exclusion in others.[18] Prevailing Section 2 standards accordingly put courts and enforcement agencies to the sometimes difficult task of determining the efficiency (or reasonableness) of various types of conduct that purportedly acquires or maintains a monopoly.[19] Nonetheless, members of the Supreme Court have acknowledged that

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16 *See* Brief Amicus Curiae of the United States of America and the Federal Trade Commission in *Trinko*, No. 02-682, at 14 (analysis of whether conduct is exclusionary does not entail "open-ended-balancing" of social gains) ("*Trinko Amicus* Brief"); Einer Elhauge, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. 253, 330 (2003) ("in monopolization cases, courts sensibly adjure open-ended balancing") ("Elhauge, *Better Standards*").

17 Sullivan & Grimes, *Handbook*, at 84-85.

18 *Cf. FTC v. Gratz*, 253 U.S. 421, 438 (1920) (Brandeis, J., dissenting) ("[W]hat approximately equal individual traders may do in honorable rivalry may result in grave injustice and public inquiry, if done by a great corporation in a particular field of business which it is able to dominate.").

19 *See* Shapiro Statement, at 3 ("there are a great many distinct types of exclusionary conduct, just as there are a great many dimensions to legitimate competition.").

conduct by monopolists requires special scrutiny—“a special lens”—because conduct by a monopolist can have exclusionary effects.[20]

In the absence of information and adjudication costs, courts and enforcement agencies could directly implement a monopolization standard that determines whether a practice’s exclusionary impact was the result of its cost-reducing quality. Enforcement costs are not zero, however. They generally take two forms: (i) administrative costs (including the cost of litigation), and (ii) “primary conduct” costs.[21] Primary conduct costs take two forms. First, there are so-called false positives, or “Type I” errors—that is, erroneous determinations that legitimate conduct is unlawful.[22] Such errors punish legitimate conduct and can deter similar conduct in the future.[23] Second, there are so-called false negatives, or “Type II” errors—that is, erroneous determinations that harmful conduct does not violate the antitrust laws.[24] Such errors impose the costs of the anticompetitive conduct on consumers and society.

One witness explained these costs as follows:

> For many types of conduct, in practice the boundary between exclusionary conduct and legitimate competition is necessarily a fuzzy and controversial one, and our legal system is inevitably imperfect in assessing in a given case whether the conduct in

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20 *Kodak*, 504 U.S. at 488 (Scalia, J., dissenting).

21 One witness put it somewhat differently, stating that there are three such costs: “Error costs, administrative costs, and uncertainty costs.” *See* Trans. at 13 (Rule).

22 *See* Shapiro Statement, at 3 (defining “false positive” as case in which companies engaging in legitimate competition are ruled in violation of the antitrust law”).

23 *See Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986) (opining that mistaken condemnations of legitimate pricing conduct “are especially costly, because they chill the very conduct the antitrust laws are designed to protect.”); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.); *cf. Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 767-68 (“It is sometimes difficult to distinguish robust competition from conduct with long-run anticompetitive effects.”).

24 *See* Shapiro Statement, at 3-4 (defining false negative as instances “in which companies engaging exclusionary conduct are not found to have violated the antitrust laws.”).

> question falls on one side of this boundary or the other. Therefore, in crafting and enforcing the antitrust laws, great attention should be paid to possible legal errors: false positives in which companies engaging in legitimate competition are ruled in violation of antitrust law, and false negatives in which companies engaging in exclusionary conduct are *not* found to have violated the antitrust laws.[25]

In light of these considerations, courts and the enforcement agencies have developed various tests for determining whether or not challenged conduct is more likely predatory and unlawful or efficient and lawful.[26] For example, courts are especially reluctant to interfere with the pricing decisions of a single firm. Thus, courts have developed a particularized rule for predatory pricing cases under which a monopolist's pricing conduct will violate Section 2 only if a plaintiff can show: (1) that the monopolist is setting prices below an appropriate measure of cost, and (2) that the structure of the market is such that the monopolist likely will be able recoup

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25 *Id.*

26 Then-Judge Breyer explained the need for such simplifying rules more than two decades ago:

> [W]hile technical economic discussion helps to inform the antitrust laws, those laws cannot precisely replicate the economists' (sometimes conflicting) views. For, unlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve.

See Barry Wright, 724 F.2d at 234; *see also* Shapiro Statement, at 3-4. One witness expressly endorsed the reasoning of Justice Breyer in *Barry Wright*. *See* Trans. at 10 (Popofsky) (stating that *Barry Wright* is "one of the most important cases ever decided"). Two other witnesses embraced similar reasoning without mentioning the decision. *See* Trans. at 55-56 (Rule) ("I think the issue is that: how do you—can you really develop a cost-effective rule for evaluating [the impact of unilateral conduct] in these circumstances."); Shapiro Statement, at 3-4.

the losses that below-cost pricing will impose upon it.[27] As a result, above-cost pricing by a monopolist falls within a safe harbor—that is, it is lawful *per se*. The safe harbor for above-cost pricing reflects a determination (i) that such pricing often makes economic sense apart from any prospect of obtaining or protecting market power and enhances purchaser welfare in the short run, and (ii) that courts are ill-equipped to distinguish harmful from beneficial price cuts without over deterring procompetitive conduct.[28]

In other areas, courts engage in a more extended "rule of reason" (or modified rule of reason) analysis.[29] In cases involving exclusionary agreements with input suppliers, such as tying or exclusive dealing arrangements, for example, courts (simply stated) ask whether the agreement substantially forecloses competition in a market, thereby creating or perpetuating monopoly power, without any legitimate business justification.[30] In general, a plaintiff must

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[27] *See Brooke Group*, 509 U.S. at 223 (Section 2 does not forbid above-cost pricing that preserves a dominant position).

[28] *See Brooke Group*, 509 U.S. at 223; Phillip Areeda and Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697, 733 (1975) ("Areeda, *Predatory Pricing*") (proposing prices above average variable cost presumptively lawful, and prices below average variable cost presumptively predatory); *see also* Shapiro Statement, at 4; Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2; The No Economic Sense Test*, 73 Antitrust L.J. 413, 418-20 (2006) (explaining how *Brooke Group* created a "prudential safe harbor" for above-cost pricing) ("Werden, *No Economic Sense*").

[29] Courts may also employ a "quick look" analysis where "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets." *California Dental Ass'n v. FTC*, 526 U.S. 756, 770 (1999); *see also* ABA Section of Antitrust Law, *Antitrust Law Developments*, at 247 (5th ed. 2002) ("Although courts seldom have attempted to articulate general principles for distinguishing competitive from anticompetitive conduct, courts have held conduct to be predatory where it would be economically irrational for the monopolist but for the conduct's adverse impact on competition") ("*Antitrust Law Developments*").

[30] *Eastman Kodak*, 504 U.S. 451; *United States v. Dentsply International*, 399 F.3d 181 (3d Cir. 2005); *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001); *see also* Trans. at 124 (Pitofsky) (monopolist can enter exclusive dealing arrangements with ten percent of market's dealers without offending Section 2).

first establish the existence of the restriction and the requisite exclusionary impact. Once the plaintiff establishes a *prima facie* case, to avoid liability, the defendant must then provide evidence that the arrangement produces significant procompetitive benefits and is no more restrictive than reasonably necessary to achieve those benefits.[31] If the defendant makes this showing, then the plaintiff either must rebut the claim of procompetitive benefits or show that the anticompetitive harm nevertheless "outweighs" those benefits.[32]

While articulated in different ways, the various standards employed by the courts are all efforts to identify conduct that: (1) excludes rivals from the marketplace (2) on some basis other than efficiency.[33] Moreover, they seek to identify such conduct without imposing undue enforcement costs.

II. Discussion of Issues

A. <u>Should the Substantive Standards for Determining When Conduct is Exclusionary or Anticompetitive Under Section 2 of the Sherman Act be Revisited?</u>

Witnesses and commentators almost universally agreed that there was no need to revise Section 2 or materially change the standards that have developed under Section 2. Instead, as discussed in the following sections of this memorandum, some witnesses and commentators

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[31] *See Eastman Kodak*, 504 U.S. at 483 (once plaintiff makes out a *prima facie* case, "liability turns, then , on whether 'valid business reasons' can explain [the defendant's] actions), *citing Aspen Skiing Co.*, 472 U.S. at 600-605; *Dentsply,* 399 F.3d at 187, 196-97; *United States v. Microsoft Corp.*, 253 U.S. 34, (D.C. Cir.), *cert. denied*, 122 S.Ct. 350 (2001).

[32] *See* Jonathan M. Jacobson & Scott A. Sher, *"No Economic Sense" Makes No Sense for Exclusive Dealing*, at 29-30 (Manuscript) (forthcoming 73 Antitrust L.J. (2006)) ("Jacobson, *No Sense*").

[33] *See* Shapiro Statement, at 2-3 (defining "legitimate competition" as that which "benefits consumers"); Dennis W. Carlton, *A General Analysis Of Exclusionary Conduct and Refusal to Deal—Why* Aspen *and* Kodak *Are Misguided*, 68 Antitrust L.J. 659, 671 (2001) ("The key issue is whether one can distinguish when these theories imply a harm to competition as distinct from a harm to a rival.").

suggested ways in which the courts and antitrust enforcers might improve the clarity, accuracy, predictability, and/or administrability of those standards.

Only one witness recommended statutory change (specifically, to repeal Section 2).[34] No other witness agreed with this proposal, although several suggested that private damages for violation of Section 2 should be limited actual, rather than treble, damages.[35]

No witness or commenter argued that possession of monopoly power should itself be unlawful or presumed to arise from anticompetitive conduct (a "no-fault" or "no conduct" monopolization standard),[36] and several criticized such an approach.[37]

The Commission also asked particularly witnesses and commenters who believe current standards are not appropriate or clear how standards for exclusionary conduct should be determined—*e.g.*, through legislation, judicial development, and/or *amicus* efforts by DOJ and

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[34] *See* Rule Statement, at 5-15. Rule argued that most conduct currently governed by Section 2 doctrine is concerted action that is also subject to Section 1 of the Sherman Act. *Id.* at 11-13. To the extent Section 1 would not reach purely unilateral conduct—such as refusals to deal, pricing and output decisions—Rule argues that such conduct rarely reduces consumer welfare, does so only indirectly, and is difficult to evaluate. *Id.* at 4-6, 11-12.

[35] *See* Trans. at 62 (Glazer); Trans. at 63 (Popofsky); Trans. at 64-65 (Tom). *But see* Trans. at 65-66 (Salop) (single damages may not be sufficient for compensation or deterrence). The witnesses did not discuss whether proposed de-trebling would apply to challenges to conduct under Section 1 as well, or whether the same conduct would be subject to de-trebling or not depending on what provisions of the Sherman Act the plaintiff invoked.

[36] *See* National Commission for the Review of Antitrust Laws and Procedures, *Report to the President and the Attorney General*, at 150-63 (1979); *cf.* Eleanor M. Fox, *Monopoly And Competition*; *Tilting The Law Towards A More Competitive Economy*, 37 W. & L. L. Rev. 49 (1980) (advocating "no conduct" approach to monopolization doctrine, whereby proof of monopoly would itself establish liability under Section 2); John J. Flynn, *Statement to the Federal Trade Commission*, 48 Antitrust L.J. 845 (1979) (same).

[37] *See* Trans. at 121 (Pitofsky) (Section 2 should not ban obtaining monopoly power through superior skills foresight, and industry); Trans. at 123-24 (Pitofsky) (Section 2 should not ban practices that entrenches monopoly to some extent if it has efficiency justifications); Trans. at 122 (Shapiro) (agreeing that conduct that maintains or acquires monopoly should not *ipso facto* violate Section 2); Trans. at 125-26 (Pate) (agreeing that mere acquisition or maintenance

FTC. Almost universally, they recommended that the appropriate standards should evolve in the courts and that the federal enforcement agencies should use appropriate opportunities to aid development of the law.[38] Indeed, the FTC and DOJ are currently soliciting comment and holding hearings on Section 2 standards,[39] and the FTC is co-chairing the International Competition Network Unilateral Conduct Working Group, which plans to make an in-depth study of the issue over the next several years.

B. What Are the Circumstances in Which a Firm Refuses to Deal With (Or Discriminations Against) Rivals in Adjacent Markets Violates Section 2 of the Sherman Act? Does the Supreme Court's Decision in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko. LLP*, State an Appropriate Legal Standard in this Respect?

1. Background

As the Supreme Court recently held in *Trinko*, the "Sherman Act 'does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business freely

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of a monopoly should not violate Section 2); Trans. at 127 (Muris) (same); Glazer Statement, at 2 ("not everything that is designed to exclude rivals is necessarily illegal or predatory").

38 Glazer Statement, at 11 ("I think it is unnecessary at this time to amend the statute."); Popofsky Statement, at 21 ("Given our common law tradition, I, for one, hope that the issue of price predation will be sorted out in our traditional adjudicatory process."); Pate Statement, at 1 ("I do not believe the Commission should recommend legislative change. Rather, enforcement agencies, courts and private litigants should continue to push the law in the direction of increased objectivity, transparency and administrability."); Pitofsky Statement, at 9 ("A proposal for legislative reform seems to me unwise and probably impractical."); Shapiro Statement, at 5 ("I do not see any simple way of enacting broad new legislation to improve the operation of antitrust law in the area of exclusionary conduct."). Mr. Rule, the sole witness who recommended repeal of Section 2 recognized that repeal was unlikely. Rule Statement, at 15. He accordingly made ten suggestions for courts to consider in deciding Section 2 claims, which would not be effectuated through legislative change. *Id.* at 16-17.

39 *See* Thomas O. Barnett, *The Gales of Creative Destruction: The Need for Clear and Objective Standards for Enforcing Section 2 of the Sherman Act*, Opening Remarks for FTC and DOJ Hearings Regarding Section 2, at 2-3 (June 20, 2006) (hearings to increase understanding and advance development of law)

to exercise his own independent discretion as to parties with whom he will deal.'"[40] Nevertheless, in certain circumstances, even a unilateral refusal to cooperate with rivals can constitute anticompetitive conduct.[41]

Firms sometimes refuse to deal with rivals in a manner that appears to place those rivals at a competitive disadvantage. For instance, a vertically integrated firm with a monopoly in an upstream input market may decline to sell such inputs to downstream rivals or it may demand a price the rival regards to be too high.[42] Alternatively, a firm with a monopoly over downstream distribution facilities may refuse to distribute its rivals' products or distribute them only in a disadvantageous manner.[43]

Such refusals to deal may disadvantage the monopolist's rivals by depriving them of an essential input or forcing them to pay an unreasonable price for it. In this way, a vertically integrated monopolist theoretically may be able to extend its power into an adjacent market or maintain its power in the upstream or downstream market. In some circumstances, this strategy may allow the monopolist to earn greater total economic profits than it would earn simply by charging downstream rivals a monopoly price for the input products.[44] (In general, however, a

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[40] *Trinko*, 540 U.S. at 408 (quoting *United States v. Colgate & Co.*, 250 U.S. 200, 207 (1919)).

[41] *Id.*

[42] *See, e.g.*, *Trinko*, 540 U.S. 398; *Eastman Kodak*, 504 U.S. 451 (refusal to sell replacement parts to rival after-market service providers); *Delaware & Hudson Ry. v. Consolidated Rail Corp.*, 902 F.2d 174 (3d Cir. 1990) (evaluating monopolist's alleged refusal to lease trackage rights at reasonable rates); *Twin Labs, Inc. v. Weidner Health & Fitness*, 900 F.2d 566 (2d Cir. 1990) (evaluating monopolist's refusal to sell its downstream rival advertising space).

[43] *See Olympia Equipment Leasing v. Western Union Telegraph*, 797 F.2d 370 (7th Cir. 1986).

[44] *See* Salop Statement, at 3 (listing circumstances in which monopolist may earn more then one monopoly profit by obtaining power in an adjacent market); *see also* Dennis Carlton and

refusal to deal will not confer any additional economic profit on the monopolist, which can realize a full monopoly profit simply charging a monopoly price for the monopolized input product.[45]) Finally, in some circumstances, the refusal to deal may serve to entrench the existing monopoly by ensuring that a rival firm must enter two markets to compete in the original monopolized market.[46]

As described below, AMC witnesses and commenters for the most part agreed that, as held in *Trinko,* refusals to deal generally should be treated as unlawful exclusionary conduct in limited circumstances, if at all.

2. Points of General Agreement Regarding Unilateral Refusals to Deal with Rivals

Witnesses and commenters identified the following reasons for carefully limiting the circumstances where a firm may be compelled to deal with its rivals.

- Forced sharing stultifies the incentives of smaller firms to develop alternatives to the monopolist's product.[47]

Jeffery Perloff, *Modern Industrial Organization* 510-20 (1994) (describing conditions under which forward integration will add to a firm's monopoly profits) ("Carlton & Perloff, *Modern*").

45 Carlton & Perloff, *Modern*, at 510-20; Shapiro Statement, at 11 ("Since 'mere' monopoly pricing is not illegal, the goal of imposing a duty on the vertically integrated firm to sell its input presumably is not to prevent that firm from 'merely' exploiting its input monopoly, but rather to prevent some additional harm resulting from expansion of the input monopoly to other markets or over time.").

46 *See* Salop Statement, at 3 ("The defendant may use a refusal to deal to raise entry barriers into the input market facing the unintegrated competitors, thereby protecting its dominance of the input market. This effect sometimes is called the "2-level entry" theory."); Shapiro Statement, at 11 ("If the integrated firm's refusal to sell its input to a downstream rival causes that rival to exit the market, subsequent entry into the *upstream* market may become more difficult, due to need for two level entry.").

47 Shapiro Statement, at 11 ("requiring the vertically-integrated firm to lower the price at which it sells its input to its downstream competitor, has a direct effect of *reducing* the incentives of third parties to enter the upstream market.") (emphasis supplied); Herbert Hovenkamp, *Federal Antitrust Policy*, 299 (3d ed. 2005) (forced sharing "undermines the

- “Competition on the merits” depends upon a right to refuse to deal with rivals.[48] Absent such a right, a firm that lawfully obtained a monopoly through investment and superior acumen, skill, foresight, or industty would find itself forced to share the fruits of its investment and innovation with rivals, thereby undermining its lawfully acquired monopoly.[49] Because investment in new facilities and assets generally enhances welfare, antitrust rules that might discourage such activity should be avoided.[50]

- Economic progress and innovation requires the recognition and enforcement of property rights, which may entail the exclusion of rivals in a way that reduces consumer welfare in the short run.[51] However, while forced sharing might increase short-run rivalry, it could at the same time dampen incentives for innovation and investment by all companies (including not only the monopolist, but its rivals, who may no longer need themselves to invest in innovation or the

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competitive market process of forcing firms to develop their own sources of supply”) (“Hovenkamp, *Antitrust Policy*”); *Trinko*, 540 U.S. at 408; *Trinko Amicus* Brief, at 17 (“A firm that has the right to utilize an input from an incumbent—or that can claim that right through litigation—may have a reduced financial incentive to develop the input itself.”).

48 *See* Meese, *Monopolization*, at 761-62 (describing how “competition on the merits” as a property-based concept); *see also* Einer Elhauge, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. 253, 294-305 (2003) (relying upon property rights logic to justify very related standards governing refusals to deal).

49 *See Trinko*, 540 U.S. at 407 (“The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free enterprise system. The opportunity to charge monopoly prices—at least for a short period—is what attracts ‘business acumen’ in the first place.”); *id.* (“Compelling such firms to share the source of their advantage is in some tension with the underlying purposes of the antitrust law, since it may lessen the incentive of the monopolist, the rival, or both to invest in those economically valuable facilities.”); *see also* Shapiro Statement, at 12 (“Short run customer benefits can be obtained by weakening property rights and/or imposing duties on firms that have previously made investments to serve customers . . . Taken alone, [these considerations] would imply that any monopolist (or any supplier for that matter) should be forced to give away its product free of charge. [But] Antitrust scholars and courts generally recognize that the long-run interests of customers are served by establishing well-defined property rights and respecting these rights, even if they lead to market power.”).

50 *See* Rule Statement, at 17 (investment in “development and deployment of technological innovation should be viewed as an efficiency justification, and never a threat to consumer welfare.”); Shapiro Statement, at 4 (advocating the use of a safe harbor for investment in “new and superior production capacity” and “unadorned product improvement”).

51 *See* Shapiro Statement, at 12 (“Antitrust scholars and courts generally recognize that the long-run interests of consumers are best served by establishing well-defined property rights and respecting those rights, even if they lead to *ex post* market power.”).

development of production capacity in order to realize the benefits) and thereby reduce long-term rivalry and welfare.[52]

- Forced sharing requires courts to determine the price at which such sharing must take place, thereby transforming antitrust courts into price regulators.[53] The limited capacity of courts to determine the appropriate price a monopolist could charge would likely dampen monopolists' incentives and ultimately disserve the interests of consumers.[54] Required dealing pursuant to such price caps would also dampen the incentives of potential entrants to develop substitutes for the monopolist's product.[55]

In light of these general concerns, most AMC commenters and witnesses generally agreed that refusals to deal with horizontal rivals should rarely, if ever be unlawful.[56] All

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52 *See AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366, 428-29 (1999) (Breyer, J., concurring and dissenting in part) ("[A] sharing requiring may diminish the original owner's incentive to keep up or to improve the property by depriving the owner of the fruits of the value-creating investment."); Elhauge, *Standards*, at 294-305; Hovenkamp, *Antitrust Policy*, at 299. Some others might add that, subject to certain exceptions, a firm with a monopoly cannot enhance its profits by refusing to sell its product to downstream rivals. *See Trinko Amicus* Brief, at 17 ("Consumers are generally 'no better off when a monopoly is shared; ordinarily price and output are the same as they were when one monopolist used the input alone.'" (*quoting* 3A Areeda & Hovenkamp, ¶ 771b, at 171-72)).

53 Shapiro Statement, at 12; Rule Statement, at 14; *see Trinko*, 540 U.S. at 408 ("Enforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill-suited."); *see also Iowa Utilities Bd.*, 525 U.S. at 428 (Breyer, J., concurring in part and dissenting in part) ("Even the simplest kind of compelled sharing, say, requiring a railroad to share bridges, tunnels, or track, means that someone must oversee the terms and conditions of that sharing."). *But cf. Kodak*, 504 U.S. at 485 ("[O]ne of the evils proscribed by the antitrust laws is the creation of entry barriers to potential competitors by requiring them to enter two markets simultaneously.").

54 Shapiro Statement, at 12 ("The experience of industry-specific regulation, including traditional public utility regulation, makes me doubt that the courts are well placed to control unconditional refusals to deal by dominant firms."); Rule Statement, at 14 (terming such price regulation "costly and perverse"); *id*. (such regulation "almost certainly reduces the monopolist's return on the asset (or assets) that the monopolist is required to share."); *id*. ("potential threat of what amounts to expropriation of monopolist's property, moreover, raises some uncertainty throughout the economy . . .").

55 Shapiro Statement, at 11.

56 *See* Trans. at 162 (Pitofsky) ("I would generally support the view you don't have to deal with anybody if you don't want to. But there are very rare exceptions."); Glazer Statement, at 4 (unlawful refusals to deal should be "a rare bird"); Rule Statement, at 16-17 (refusals to deal

witnesses also generally agreed that consumer welfare should be the touchstone of any analysis[57] and that Section 2 should be reserved for "durable" monopoly power.[58]

3. Proposed General Standards for Refusals to Deal

Several witnesses and commenters, as well as other commentators, have proposed more general tests for analyzing exclusionary conduct, and refusals to deal in particular. Two of the principal approaches advanced at the hearings are a rule of reason test centered on a pricing benchmark (which was labeled by its sponsor as the "consumer welfare effect test") and a "no economic sense" or "profit sacrifice" test. A third proposal advanced focuses on whether the conduct or pricing at issues is coercive or provides incentives.

a. "Consumer Welfare Effect" Test

Professor Salop advocated a "consumer welfare effect test," which he describes as being modeled on the balancing test that courts currently employ when conducting rule of reason

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should be lawful *per se*); Shapiro Statement, at 13-16 (advocating *per se* legality except where there has been a prior course of dealing); *see also* Trans. at 158-59 (Pate) (appearing to endorse rule of per se legality for refusals to deal even when there has been a prior course of dealing).

[57] Most commentators and witnesses used the term "consumer welfare" to mean consumer surplus, as distinguished from total welfare. Two witnesses, however, equated the term "consumer welfare" with overall welfare. *See* Rule Statement, at 2 ("[T]he law is concerned with private conduct that reduces total surplus by diminishing allocative efficiency without yielding a countervailing improvement in productive (or technical) efficiency."); Pate Statement, at 8 (equating "consumer welfare" with "economic welfare"). Other witnesses generally used the term "consumer welfare" to refer to consumer surplus, and the term "total welfare" to include both consumer and producer surplus. *See, e.g.*, Salop Statement, at 5 (under "consumer welfare effects" test, liability turns on whether conduct results in "supra-competitive prices"); Statement of Jonathan B. Baker, Hearing on Efficiencies in Merger Enforcement, at 10 n.24 (Nov. 17, 2005). For convenience and clarity, the term "consumer welfare" is used here to refer to consumer surplus.

[58] *See* Rule Statement, at 16; Trans. at 78-79 (Salop); *see also* Trans. at 85 (Salop) (stating that a durable monopoly is one that is "protected by barriers to entry."); Trans. at 85-86 (Salop) (declining to opine regarding persistent a monopoly would have to be to count as "durable").

analysis under Section 1 of the Sherman Act.[59] Ultimately, the purpose of this test is to determine whether the refusal to deal would enable the monopolist to charge supra-competitive prices in any market, including the monopolized input market, the related output market in which the rival competes or seeks to compete, or any market in which the rival's customers or the producers of a complementary product would compete with the defendants.[60]

Salop's consumer welfare effect test employs a multi-step analysis.[61] First, a court would determine whether the defendant possessed monopoly power in a relevant market for inputs employed by the firm's rivals. If so, then the court next would determine whether the defendant's refusal to sell such inputs—or its insistence on terms so unattractive as to constitute an effective refusal to deal (a "non-negotiable" refusal to deal)—would lead to supra-competitive prices in a market.[62]

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59 *See* Salop Statement, at 5-16; *accord Microsoft*, 253 F.3d at 41; Jacobson, *No Sense*, at 29; *cf. Capital Imaging Associates PC v. Mohawk Valley Med. Assocs., Inc.*, 996 F.2d 537 (2d Cir. 1993) (articulating rule of reason balancing test under Section 1).

Another witness advocated a *quasi*-balancing test for implementing Section 2 without endorsing any particular balancing test for refusals to deal. *See* Pitofsky Statement, at 6-7 (endorsing general Section 2 balancing test and noting that exact content of such a test might vary depending upon the sort of conduct being scrutinized); Trans. at 124 (Pitofsky) (same). In addition, the American Antitrust Institute advocates a four part test that is similar, but not identical, to Prof. Salop's consumer welfare effects test. *See* AAI Comments, at 15-16. Under this test—which AAI says is consistent with Supreme Court decisions—a monopolist's refusal to deal would presumptively be unlawful if it purposely disadvantaged rivals in a manner that "is likely to deny an identifiable class of consumers or end users specific expected benefits of competition," so long as there is "no non-exclusionary or otherwise legitimate business justification for the challenged conduct." *See* AAI Comments, at 15-16; *cf*. Jonathan B. Baker, *Promoting Innovation Competition Through The Aspen/Kodak Rule*, 7 Geo. Mas. L. Rev. 495, 502 (1999) (contending that refusal's harm to rivals should itself suffice to establish a *prima facie* case of monopolization).

60 *See* Salop Statement, at 5.

61 *See id.* at 5-12

62 *See id.* at 2, 5-6.

Salop acknowledged that a rule requiring a monopolist to share inputs or facilities with its rivals at *any* price could destroy a firm's incentive to develop the capacity to produce such inputs in the first place.[63] His test would therefore also impose a third element, requiring the plaintiff to demonstrate that the rival was willing to pay a *sufficient* price for the monopolized product. The fact finder would ask whether the rival was willing to pay a price high enough to support an inference that the refusal to sell at that price was exclusionary—what Salop calls the "non-exclusionary benchmark price."[64] If, for instance, if the rival offered a price below the monopolist's cost of production, the refusal to deal would *not* be considered to be exclusionary, even if it reduced rivalry and increased consumer prices in the short run.[65]

The monopolist could rebut a *prima facie* claim by showing that the refusal was necessary to create efficiencies and that these efficiencies counteract any harmful impact of the refusal.[66] The court would then balance the harmful effects of the refusal against the benefits proved by the defendant in way analogous to analysis courts employ in the merger and Section 1 context.[67]

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63 *See id.* at 7 ("the integrated firm generally should be entitled to earn a return on input sales commensurate with whatever market power it has achieved legitimately. A return on this investment in the input technology also was needed to maintain adequate investment incentives."); *see also* Shapiro Statement, at 12 (exclusive short term focus on purchaser welfare would require all firms to give away their products for free); Glazer Statement, at 5 ("Of course the consumer can be made better off in the short run by forcing the monopolist to share with rivals. The consumer can also be made better off by prohibiting the monopolist from charging a monopoly price. But we don't do that, as noted in the previous section, because it would remove the incentive to invest and innovate.").

64 Salop Statement, at 7.

65 *Id.* at 6-7.

66 *See id.*

67 *See, e.g.*, Department of Justice and Federal Trade Commission Joint Merger Guidelines, § 4.0; *Capital Imaging*, 996 F.2d at 543 ("Ultimately it remains for the fact-finder to weigh the harms and benefits of the challenged behavior").

Salop proposed alternatives for calculating the "non-exclusion price benchmarks."[68] One alternative is the price that a non-vertically integrated supplier with the same degree of market power would charge. A second is the price that would generate the same combined profit level for the monopolist from the input and output markets as the monopolist would achieve by refusing to deal—the "protected profits" benchmark.[69] Both benchmarks, according to Salop, respect the right of a monopolist to exploit existing market power in the input market, even if it was not achieved through innovation. In addition, Salop offered a "simple approximation" to the protected profits benchmark with the following features.

- Where the monopolist and its rival had a prior course of dealing that was terminated by the monopolist, the presumptive non-exclusion benchmark price would be the price at which they had been dealing, or at which the defendant sells to other purchasers.

- The benchmark price would be higher if selling to the rival would raise the monopolist's costs. The monopolist would not be required to sell to its rival, however, if doing so would raise the monopolist's own costs "prohibitively"—*e.g.*, so that the monopolist could not supply its own needs or would be subject to "prohibitive reputational or other free-riding problems."

- Where the monopolist failed to respond in good faith to a rival's price offer the monopolist would bear the burden of establishing that the rival's offer exceeded

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68 *See* Salop Statement, at 10. He suggested that "the AMC could make an important contribution to the analysis of refusals to deal by holding follow-up hearings to evaluate" them. *Id*.

69 *See* Steven C. Salop, "Proposed Legal Rule for Unilateral Refusals to Deal", at C1 (Sept. 28, 2005) ("Salop, Suppl. Statement"). Under one version, the benchmark price would presumptively be measured as $W = C_a + D_x (P – C_a – C_d)$, where W is the benchmark price; C_a is the defendant's incremental unit cost of producing the input; D is the fraction of the rival output sales that entail a reduction in its output sales; and C_d is the defendant's incremental unit cost of producing the output product (other than the cost of the product supplied to the rival(s)). According to Salop, the protected profits test was first developed by Ordover and Willig in the context of their profit-sacrifice test for refusals to deal in regulated industry, where it was referred to as the "efficient components pricing rule." *See* Salop Statement, at 9 n.5 (citing Janusz Ordover and Robert D. Willig, *Access and Bundling in High-Tech Markets*, in Jeffrey A. Eisenach and Thomas M. Lenard, eds., *Competition, Innovation, and the Microsoft Monopoly: Antitrust In The Digital Marketplace* 103 (1999)).

the non-exclusionary benchmark and was not a "valid" offer. (An outright, or "non-negotiable," refusal to deal is equivalent to charging an infinite price.[70])

- The court could apply a lower benchmark where the defendant's input product monopoly power has not been obtained or maintained due to some unlawful conduct other than the refusal to deal. Under no circumstances, however, would a court require the monopolist to sell at a price below marginal cost.

Professor Salop acknowledged that estimating the benchmark price would be subject to error. He accordingly proposes that an "efficient legal rule" would "place somewhat less emphasis" on this type of evidence and focus on other, more reliable evidence, such as actual impact of the refusal to deal on price in the relevant markets, analysis of relevant market conditions, analysis of efficiency benefits, and evidence relating to profit sacrifice or the "no economic sense" standards.[71]

Professor Salop advanced the following benefits of his proposed approach, including responses to critiques of the proposal:

- The consumer welfare effects test will minimize the number of false negatives compared to the "no economic sense test" and a rule of *per se* legality. Liability would depend on a showing by the plaintiff of actual or probable anticompetitive effect and thus could not be found where the defendant lacked market power in the output market. In contrast, a refusal to deal might involve a sacrifice of profits or "make no economic sense" even where there was no discernible impact on price in the output market or consumer welfare. [72]

- Well-counseled firms will be able to comply with the rule, the application of which will be based upon the state of affairs faced by the firm at the time of the refusal.[73] The consumer welfare standard would condemn conduct only if the anticompetitive effects were reasonably foreseeable.

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70 *See* Salop Statement, at 8 (noting "important distinction" between negotiable and non-negotiable refusals to deal); *id.* at 10 (non-negotiable refusal the equivalent of refusing offer at non-exclusionary benchmark price); *cf*. Shapiro Statement, at 6 (outright refusal to deal is the same as charging a very high price).

71 *See* Salop Statement, at 10.

72 *See id.* at 12.

73 *See id.* at 15-16.

- The test would protect monopolists' incentives to innovate by assuring that they can reap a monopoly price in the input product market. The non-exclusionary benchmark price should exceed marginal cost, and at least equal the monopoly price of the input in question. Thus defined, the non-exclusionary benchmark price will not prevent monopolists from realizing the legitimate fruit of their efforts.[74]

- The test would enhance the incentives of smaller firms to innovate by assuring that they can secure essential inputs.[75]

- Courts and the enforcement agencies can develop techniques for implementing the test similar to those employed in other antitrust contexts. The fact that implementation of the test is difficult is not a reason to abandon trying.

- Calculating the "non-exclusionary benchmark price" is no more difficult than determining whether a refusal "makes economic sense," insofar as the latter determination logically entails an inquiry into whether the price forgone by the monopolist exceeded such a benchmark.

- The test does not condemn all refusals to deal in the name of consumer welfare.[76]

- The requirement that plaintiffs prove that a refusal produces significant competitive harm could filter out a significant number of baseless challenges, depending upon the nature of the showing required to establish such harm.[77]

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[74] Salop Statement, at 7 ("[T]he integrated firm generally should be entitled to earn a return on input sales [commensurate] with whatever market power it has achieved legitimately."). One scholar has characterized Professor Salop's test as a "static market-wide balancing test," as distinguished from a dynamic market-wide balancing test. *See* A. Douglas Melamed, *Exclusive Dealing Agreements and Other Exclusionary Conduct—Are There Unifying Principles?*, 73 Antitrust L.J. 375, 386-87 & n.29 (2006) ("Melamed, *Exclusive Dealing*").

[75] *See* Salop Statement, at 17.

[76] *See id.* at 6 ("One might think that a standard focused solely on price and quantity necessarily would be violated by any refusals to deal. Short run consumer welfare would increase if the unintegrated firm is able to enter the market, and it might be assumed that the lower the input price, the better the outcome.").

[77] *Compare* Jonathan B. Baker, *Promoting Innovation Competition Through The Aspen/Kodak Rule*, 7 Geo. Mas. L. Rev. 495, 502 (1999) (concluding that Supreme Court precedent does "not consider effect on competition in determining whether the monopolization offense [can] be found" but instead relies on impact of conduct on rivals) *with* Timothy J. Muris, *The FTC and the Law of Monopolization*, 67 Antitrust L.J. 693 (2000) (arguing that current law requires a more detailed showing of harm to consumers before condemning a monopolist's conduct).

Several AMC witnesses, as well as other commentators, raised a number of concerns about Prof. Salop's consumer welfare effect test.

- The test creates significant compliance costs, as it requires monopolists contemplating a refusal to deal to determine the non-exclusion benchmark price and whether a refusal to sell at that price will in fact injure consumers.[78] This latter inquiry would entail a determination whether rivals would be able to obtain alternative, cost-effective sources of supply, and whether, in fact the refusal would harm competition in some market.[79]

- Judicial oversight of refusals to deal would entail significant administrative costs. In those cases in which a refusal did produce anticompetitive harm, courts would have to determine whether the price offered by the monopolist's rival was high enough to establish that the defendant's refusal to sell at that price was exclusionary.[80]

- Courts are not rate-making bodies and are ill-equipped to determine the "non-exclusion benchmark price" as required by this test.[81] Insofar as courts will sometimes set this price too low, the consumer welfare effects test would deprive monopolists of the fruits of their efforts.[82] Moreover, reliance upon prices charged to non-rivals as a benchmark may cause the dominant firm to raise those prices as well, thus distorting the allocation of resources and injuring welfare.[83]

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78 Pate Statement, at 10-11; Melamed, *Exclusive Dealing*, at 387 ("static market-wide balancing test . . . would pose a daunting challenge to any decision maker and would place a costly and almost impossible burden on the defendant when deciding in real time how to conduct its business.").

79 *See generally* Pate Statement, at 10.

80 *See* Shapiro Statement, at 12.

81 *See* Pate Statement, at 3 (arguing that courts can readily administer the "no economic sense" test); *id*. at 8-12 (arguing that "no economic sense" test is easier to administer than the consumer welfare effects test); Shapiro Statement, at 12 (experience with regulation "makes me doubt that the courts are well-placed to control unconditional refusals to deal by imposing price caps and regulating the terms of which dominant firms deal.").

82 *See* Pate Statement, at 3-5; *see also* Shapiro Statement, at 12-13 (advocating rule of *per se* legality for vertical refusals to deal because any regime imposing such duties will weaken property rights so as to dampen innovation incentives).

83 *See* Shapiro Statement, at 13.

- Requiring a monopolist to deal with rivals at a court-determined price could undermine the incentives that rivals and other suppliers might have to develop inputs of their own.[84]

- Reliance upon a prior course of dealing to set the non-exclusionary benchmark price could deter the monopolist from embarking on that course of dealing in the first place.[85]

- If harm produced by an unjustified refusal coexists with benefits, this test would require courts to balance these harms and benefits against one another to determine which predominate, a daunting, expensive task that is prone to error.[86] This test, however, would require courts to develop some baseline level of purchaser welfare against which to measure the impact of the refusal to deal.[87]

- The test's definition of "consumer welfare" does not include regard for the "total welfare" of all of society's consumers.[88] The test's focus on "consumer welfare" would seem to mean that any refusal to deal resulting in higher prices would establish a *prima facie* case."[89] (The defendant would still be allowed to demonstrate countervailing procompetitive efficiencies, however.)

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84 Shapiro Statement, at 11 ("requiring the vertically integrated firm to sell its input to its downstream competitors has a direct effect of reducing the incentives of third parties to enter the upstream market."); Glazer Statement, at 5; *see also* Hovenkamp, *Antitrust Policy*, at 299 (forced sharing "undermines the competitive market process of forcing firms to develop their own sources of supply"); *Trinko*, 540 U.S. at 408 ("Compelling such firms to share the source of their advantage is in some tension with the underlying purposes of the antitrust law, since it may lessen the incentive of the monopolist, the rival, or both to invest in those economically valuable facilities."); *Trinko Amicus* Brief, at 17 ("A firm that has the right to utilize an input from an incumbent—or that can claim that right through litigation—may have a reduced financial incentive to develop the input itself.").

85 Glazer Statement, at 4.

86 *See* Werden, *No Economic Sense*, at 432 ("Reliance on the jury system assures that the consumer welfare test would result in a high incidence of false positive findings of exclusionary conduct.").

87 In some cases, of course, the refusal will take place after an initial course of dealing, in which case the fact-finder could employ the pre-refusal state of purchaser welfare as the baseline. *Cf. Aspen Skiing Co.*, 472 U.S. at 605-11 (prior course of dealing suggested that dealing was profitable for the monopolist at those prices).

88 *See* Rule Statement, at 2 (equating "consumer welfare" with total welfare); Pate Statement, at 8 (equating "consumer welfare" with "economic welfare").

89 *Cf. National Collegiate Athletic Ass'n v. Board of Regents University of Oklahoma*, 468 U.S. 85, 104-08 (1984) (proof that a restraint results in prices higher than otherwise would be suffices to establish a *prima facie* case under the rule of reason); *Law v. NCAA*, 134 F.3d 1010,

b. The "Profit Sacrifice" and "No Economic Sense" Tests

The "profit sacrifice" and "no economic sense" (or "NES") tests require, as a condition for liability, proof that the refusal to deal makes "no economic sense" or is unprofitable but for the refusal's tendency to fortify preexisting market power or help the monopolist acquire new market power.[90] (Doug Melamed, one of the current principal proponents of the "profit sacrifice" test acknowledges that a more accurate term for it might be the "business sense" or "no economic sense" test.[91]) If the refusal does make economic sense absent such a contribution to market power (or the expectation of acquiring market power), the conduct survives Section 2 scrutiny, without additional analysis. Thus, refusals that "make economic sense" in this way are lawful, without regard to whether a court might determine that the refusal results in a net reduction in welfare, however defined. One witness explained that the test is designed to "be consistent with the case law as it has developed."[92]

Supporters of the NES test cite two main benefits: it (1) "steers courts clear of the pitfalls lurking in application of stricter liability standards that would require greater judicial oversight," and (2) "allows businesses to understand the antitrust consequences of proposed courses of

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1019-20 (10th Cir. 1998) (proof that restraint resulted in salaries lower than those that existed before the restraint gave rise to a *prima facie* case).

90 *See* Pate Statement, at 2-11 (defending "no economic sense" test and criticizing "consumer welfare effects" test); Melamed, *Exclusive Dealing*, at 389 (advocating "no economic sense" test for all Section 2 claims); Werden, *No Economic Sense Test*. Moreover, the Department of Justice and Federal Trade Commission recently advocated such a test in an Amicus Brief filed in the *Trinko* case.

91 *See* Melamed, *Exclusive Dealing*, at 391-92 (contending that, properly interpreted, the "sacrifice" test is equivalent to the "no economic sense" test); *see also* Pate Statement, at 7-8 (*Trinko* recognized profit-sacrifice test in *Aspen* and reached holding consistent with NES test); *Aspen Skiing*, 472 U.S. at 611 (relying upon fact that "finding it significant that the defendant "was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival."). *But see* Werden, *No Economic Sense*, at 422-25 (NES test is refinement of profit-sacrifice test that avoids overinclusiveness of latter test).

conduct on the basis of information available to them as part of their normal business planning."[93] In particular, the NES test would demand fact-finders look at the conduct from an *ex ante* perspective, whereas a consumer welfare effect test runs the risk that a fact-finder will conflate *ex ante* decision-making by a business with *ex post* determinations of effects on consumers.[94] For businesses, NES proponents argue that under such a test businesses will be more able to comply because prediction of the consequences (and profitability) of a proposed course of business are routinely undertaken in planning, thus allowing the business to determine whether its actions would be profitable other than for reductions in competition they would cause.[95]

While proof that a monopolist's refusal to deal makes no economic sense is a *necessary* condition for liability under this test, it is not sufficient, and thus the test acts only as a screen.[96] The second step of the inquiry requires a determination that the conduct harmed competition.[97] Thus, under the no economic sense test, a plaintiff may prevail by proving four elements:

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92 Pate Statement, at 3.

93 *Id.*

94 *Id.* at 8-9.

95 *Id.* at 9.

96 *See* Trans. at 164 (Pate).

97 Melamed, *Exclusive Dealing*, at 391 (the "sacrifice" or "no economic sense" test includes an inquiry into whether the conduct does or will in fact protect or enhance a firm's monopoly power); *see Trinko Amicus* Brief, at 14 ("A *sine qua non* for any claim of monopolization or attempted monopolization is conduct that 'reasonably appear[s] capable of making a significant contribution to creating or maintaining monopoly power'," *quoting* 3 AREEDA & HOVENKAMP, ANTITRUST, ¶ 651F, at 83-84)); *see also* USTA Comments, at 11 (endorsing requirement of proof of harm as part of a "no economic sense" test); John E. Lopatka and William H. Page, Monopolization, *Innovation and Consumer Welfare*, 69 George Wash. Univ. 367, 387-93 (2001) (arguing that proof of actual consumer harm should be a necessary condition for establishing a violation of Section 2); Timothy J. Muris, *The FTC and the Law of Monopolization*, 67 Antitrust L.J. 693 (2000) (contending that proof of actual anticompetition effect should be a *sine qua non* of any Section 2 case); *cf. Brooke Group, Ltd.*, 509 U.S. at 224-26 (holding that some prospect of

- The defendant's possession of a monopoly over an input;
- The refusal to sell the input, or the sale of the input at a price that significantly disadvantages rivals;
- The absence of any economic rationale for the refusal, apart from its tendency to maintain or acquire monopoly power;
- The maintenance or acquisition of market power as a result of such refusal.[98]

Proponents of this test identified several advantages over alternatives.

- The test minimizes a monopolist's costs of discerning and complying with its obligations. The monopolist need only determine *ex ante* whether the refusal would make sense absent any expectation of obtaining or maintaining monopoly power.[99] Accordingly, the firm need not quantify the net impact of the refusal upon rivals (and thus consumers) before deciding with whom to deal.[100]
- Reliance upon a "no economic sense" test will minimize the costs of investigation and adjudication, since agencies and courts can apply the test without quantifying the harms, if any, produced by the refusal, and without balancing such harms against benefits.[101]

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recoupment is a necessary element of predatory pricing claim, without regard to apparent rationality (or not) of the defendant's pricing).

98 *See* Melamed, *Exclusive Dealing*, at 389-90; USTA Comments, at 10-12; IBA Comments, at 10-11; *see also Trinko Amicus* Brief, *passim*; *cf*. AAI Comments, at 15-16 (absence of legitimate business justification a necessary condition for refusal to deal liability).

99 *See* Pate Statement, at 9-10; Melamed, *Exclusive Dealing*, at 393 ("Perhaps most important, the sacrifice test provides simple, effective, and meaningful guidance to firms so that they will know how to avoid antitrust liability without steering clear of procompetitive conduct. Firms will have to ask only whether their conduct makes good business sense regardless of increases in their market power. That question is not always easy to answer, but it is likely to be far more tractable than the questions asked by market-wide balancing tests.").

100 *See* Melamed, *Exclusive Dealing*, at 387 (asserting that a "static balancing test" like the consumer welfare effects test would "place a costly and often impossible burden on defendant when deciding in real time how to conduct its business."); *see also* Robert H. Bork, *The Antitrust Paradox* 229-30 (2d ed. 1993).

101 *See* Pate Statement, at 3 ("Apart from consistency with case law and grounding in sound economic theory, the "no economic sense" test has a crucially important feature that commends its use not only in evaluating refusals to deal, but also in assessing other types of single-firm conduct: The "no economic sense" test can be administered effectively by courts and businesses alike. This test steers courts clear of the pitfalls lurking in application of stricter liability standards that would require greater judicial oversight); *see also* Melamed, *Exclusive Dealing*, at

- The approach strikes an appropriate middle ground between a minimalist approach that would potentially allow refusals to deal that have no procompetitive justification and a more interventionist approach that creates disincentives for innovation.[102]

- The test does not make legal any conduct that happens to produce some benefit that accrues to the monopolist. Rather, the test would require the conduct to produce benefits internalized by the monopolist that exceed any costs that the monopolist incurs as a result of the refusal.[103]

Witnesses and commentators offered the following criticisms of the no economic sense test.

- Because the test does not directly inquire into the net impact of the restraint upon any welfare criterion, it will produce false negatives even when perfectly administered.[104] In other words the test is under-inclusive "by design." For instance, a refusal to deal may fortify or create a significant amount of market power, thus producing real consumer and allocational harm. However, under a rigorous application of the no economic sense test, such a refusal will survive scrutiny so long as the defendant can identify and prove the existence of net benefits of the refusal, unrelated to the maintenance or acquisition of market power.[105] If the defendant proves such net benefits, no matter how slight, it avoids liability under this test, even if these benefits do not outweigh the overall harm produced by the refusal.[106]

- At the same time, others have suggested that the test could result in false positives.[107]

387, 393 (opining that application of a static or market-wide balancing test is "daunting challenge" compared to the "no economic sense" test).

102 *See* USTA Comments, at 7-10; IBA Comments, at 11.

103 *See* Werden, *No Economic Sense*, at 416 ("That conduct produces some gross benefit for the defendant is not a sufficient basis for concluding that it makes economic sense. Conduct fails the no economic sense test if it is expected to yield a negative pay off, net of the costs of undertaking the conduct, and not including any payoff from eliminating competition.").

104 *See* Salop Statement, at 12; Pitofsky Statement, at 3-6.

105 *See* Melamed, *Exclusive Dealing*, at 382, 393-94 (conceding that no economic sense can lead to fall negatives for this reason).

106 *See* Pitofsky Statement, at 4 (articulating this scenario in which "no economic sense" test produces a false negative).

107 *See* Rule Statement, at 8-9 (profit-sacrifice or NES test imposes burden on defendant to show efficiencies from conduct, which may be difficult or impossible to meet); Salop Statement,

- Effectively requires a type of balancing anyway in determining whether practice "makes sense" for reasons "other than" the harmful effect on rivals[108]

c. "Coercing" versus "Incentivizing" Conduct

Ken Glazer offered a third way of approaching exclusionary conduct. He proposes that courts focus on whether the conduct is "coercing" or "incentivizing."[109] This distinction is the third, and most important part, of a three-part inquiry that he proposes. The first part of Glazer's inquirty calls for courts to determine whether conduct is "excluding" or "exploiting."[110] Exploiting conduct is that which may be undertaken by a monopolist as a fruit of its monopoly, and should not give rise to an antitrust claim.[111] Excluding conduct is conduct that is designed to eliminate rivals, and potentially is actionable.[112] Second, Glazer calls for a determination of whether the conduct is horizontal or vertical; that is, if the conduct relates only to horizontal dealings, antitrust law should rarely (if ever) be concerned with the conduct.[113] Vertical conduct, however, may be actionable.

The principle part of Glazer's proposed approach is the determination of whether conduct is coercing or incentivizing, which is made after a determination that the conduct is excluding and vertical. Coercing conduct occurs when a firm refuses to deal with a (potential) customer

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at 8 (noting instance of localized refusal to deal that could be condemned under NES test but would not under consumer welfare effect test).

108 Jacobson, *No Sense*, at 31; Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit- Sacrifice Standard*, 73 Antitrust L.J. 311, 351-52 (2006)

109 *See* Glazer Statement, at 1.

110 *Id.* at 1-2.

111 *See id.* at 2 (citing *Trinko*)

112 *See id.*

113 *See id.* at 4.

because that customer also deals with the firm's rivals.[114] By comparison, a firm engages in incentivizing conduct when it continues to deal with a customer, despite that customer's dealing with the rival, but not necessarily on the same favorable price terms.[115]

Glazer argues that his proposed distinction is important for three reasons. First, a monopolist is uniquely capable of coercing because of its monopoly status; any firm is capable of engaging in incentivizing conduct (at least to the limits of its "checkbook").[116] Second, coercing conduct hurts the customer by issuing a "take-it-or-leave-it" choice; incentivizing conduct provides a choice to the customer.[117] Third, a monopolist's competitors can respond to incentivizing conduct by providing their own incentive offers.[118]

Glazer argues that coercing conduct should be presumptively unlawful, with the presumption overcome only if the defendant can show procompetitive justifications for the conduct.[119] Incentivizing conduct should be presumptively lawful, by comparison.[120] The only exception Glazer would allow is for price incentives that are so great that they constitute predatory pricing under the *Brooke Group* standard.[121]

Glazer identifies the following advantages to his test:

- It focuses on conduct, not effects or intent. It thus provides companies with clarity as to what conduct is permissible.[122]

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114 *See id.* at 6-7 (citing *Lorain Journal* and *Dentsply*).

115 *Id.* at 7.

116 *Id.*

117 *Id.*

118 *Id.*

119 *Id.* at 8.

120 *Id.*

121 *Id.*

122 *Id.*

- It harmonizes with tying law, because it would make unlawful only that conduct which creates the type of coercion that an unlawful tie-in creates.[123]

- It would help to clarify bundling law by requiring an inquiry only into whether the pricing was such as to be predatory.[124]

No witnesses or commenters specifically critiqued Mr. Glazer's proposed approach.

C. Should the essential facilities doctrine constitute an independent basis of liability for single-firm conduct under Section 2 of the Sherman Act?

For several decades, courts have analyzed certain refusals to deal pursuant to the "essential facilities doctrine."[125] The doctrine potentially applies when the defendant possesses a monopoly over a physical facility of some sort, to which a rival with no such facility seeks access. Classic examples in which plaintiffs have sought to invoke the doctrine include railroad tracks,[126] telephone lines,[127] a sports stadium,[128] and pipelines.[129] While several lower courts

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[123] *See id.* at 8-9.

[124] *Id.* at 9.

[125] Phillip Areeda, *Essential Facilities*; *An Epithet In Need of Limiting Principles*, 58 Antitrust L.J. 841 (1988) (recounting origins of the doctrine) ("Areeda, *Essential Facilities*"); Robert Pitofsky, Donna Anderson, and Jonathan Hooks, *The Essential Facilities Doctrine Under U.S. Law*, 70 Antitrust L.J. 443 (2002) (same) ("Pitofsky, *Essential Facilities*"). Although generally applied regarding unilateral refusals to deal, the doctrine is often noted to have originate in two Supreme Court decisions involving concerted action. *See Associated Press v. United States*, 326 U.S. 1 (1945); *United States v. Terminal Railroad Ass'n. of Saint Louis*, 224 U.S. 383 (1912).

[126] *See Laurel Sand & Gravel v. CSX Transp., Inc.*, 924 F.2d 539 (4th Cir. 1991); *Delaware & Hudson Ry. Co. v. Consolidated Rail Corp.*, 902 F.2d 174 (2d Cir. 1990).

[127] *See MCI Communications Corp. v. AT&T*, 708 F.2d 1081 (7th Cir. 1982).

[128] *See Fishman v. Estate of Wirtz*, 807 F.2d 520 (7th Cir. 1986); *Hecht v. NFL*, 570 F.2d 982, 992-93 (D.C. Cir. 1977).

[129] *Illinois* ex rel. *Burris v. Panhandle E. Pipe Line Co.*, 935 F.2d 1469 (7th Cir. 1991).

have endorsed the doctrine, the Supreme Court recently explained in *Trinko* that it has neither endorsed nor repudiated it.[130]

Lower courts that have recognized the essential facilities doctrine have articulated a four-part test for determining whether a purported denial of access to such a facility violates Section 2.[131] To establish liability, a plaintiff must show:

(1) The control of an essential facility by a monopolist;[132]

(2) The inability of a rival reasonably to duplicate the essential facility;

(3) Refusal to grant a rival access to the facility;[133] and

(4) The monopolist can feasibly grant such access to the rival in question.[134]

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130 *See Trinko*, 540 U.S. at 411 ("We have never recognized this doctrine, and we find no need either to recognize it or repudiate it here.") (*citing Aspen Skiing*, 472 U.S. at 611 & n.44 (1985); *Iowa Utilities Bd.*, 525 U.S. at 428 (Breyer, J.)).

131 *See MCI*, 708 F.2d at 1132-33; *see also Laurel Sand*, 924 F.2d 539; *Delaware & Hudson*, 902 F.2d at 179.

132 The first element overlaps significantly, if not entirely, with the requirement that a plaintiff establish that the defendant possesses monopoly power in a well-defined input market. *See Laurel Sand*, 924 F.2d at 544.

133 Although the third element suggests the need to show a complete refusal to deal with a rival, plaintiffs can satisfy this element in some courts by showing that the defendant offered nominal "access" on unreasonable terms. *See Delaware & Hudson*, 902 F.2d at 179-80 ("[T]here need not be an outright refusal to deal in order to find that denial of an essential facility occurred. It is sufficient if the terms of the offer to deal are unreasonable."); *Fishman v. Estate of Wirtz*, 807 F.2d 520, 541 (7th Cir. 1986) ("agreeing to deal on unreasonable terms is merely a type of refusal to deal."); *cf. Laurel Sand*, 924 F.2d at 544 (defendant's offer to ship plaintiff's goods at reasonable prices established the plaintiff could replicate the facility at a reasonable cost).

134 While this element suggests an inquiry into the "technical" feasibility of sharing such facilities, courts have in fact read this element as involving an inquiry into the business purpose if any, that purportedly justifies such a refusal. *See City of Anaheim v. Southern California Edison Co.*, 955 F.2d 1373, 1381 (9th Cir. 1992) (essential facility claim failed where defendant showed that granting access to plaintiff would increase prices charged other customers); *Panhandle E. Pipe Line*, 935 F.2d at 1483 (defendant's desire to minimize potential liability under take or pay contracts justified refusal to transport rivals' gas through its pipeline); *Laurel Sand*, 924 F.2d at 545 ("The feasibility of providing access to the tracks must be analyzed not in terms of the possibilities of CSX as a railroad, but in the context of its normal course of

Some courts have added the requirement that the refusal produce demonstrated anticompetitive harm in an adjacent market likely to harm consumers.[135]

Although courts initially applied the doctrine to physical facilities like sports stadia and the like, plaintiffs have in some cases successfully extended the doctrine to cover products not commonly thought of as "facilities." In *Aspen Skiing*, for instance, the Tenth Circuit affirmed a jury's finding that an "all-Aspen ticket" offered jointly by plaintiff and defendant was an "essential facility" because the plaintiff could not compete in the relevant market without access.[136] Some courts have found that intellectual property can constitute an essential

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business."); *id*. (sharing facility was not "feasible" where the defendant, "within its existing course of business. . . . articulated a number of legitimate business reasons for refusing trackage rights."); *see also* Elhauge, *Defining*, at 262 ("lower courts applying the essential facilities doctrine have interpreted its element that sharing be 'feasible' to mean the same set of open-ended factors that the Court examines to decide whether a refusal to deal is justified."). Under this approach, a court will find that sharing is not "feasible" if a defendant establishes a legitimate business reason for refusing to deal. *See Panhandle E. Pipe Line Co*., 935 F.2d at 1483; *Laurel Sand & Gravel*, 924 F.2d at 544-45; *see also Fishman*, 807 F.2d at 539 (noting lower court's finding that "defendants had refused to deal by withholding a lease, even though they had no legitimate business reason for the refusal"); *id*. at 541 (affirming as not clearly erroneous trial court's finding that there was no business justification for the refusal to accord access). Some earlier decisions can be read as imposing a somewhat higher burden on defendants in this regard. *See Hecht*, 570 F.2d 982, 992-93 (D.C. Cir. 1977) ("the antitrust laws do not require that an essential facility be shared if such sharing would be impractical or would inhibit the defendant's ability to serve its customers"). If a court decides that sharing is required, it will of course have to determine the terms on which such sharing will take place. *See* Hovenkamp, *Antitrust Policy*, at 313 (explaining that "forced sharing [under the essential facilities doctrine] requires price administration").

135 *See Twin Laboratories v. Weider Health and Fitness*, 900 F.2d 566, 568 (2d Cir. 1990) ("The existence of a facility, even if essential is a technical sense, does not constitute an antitrust violation if the plaintiff cannot allege harm to competition."). *But see Fishman*, 807 F.2d at 536 (rejecting a requirement that plaintiff carry "the burden of articulating how the welfare of the ultimate consumer has been diminished by an injury to competition *at another level*.").

136 *See* 738 F.2d 1509, 1520-21 (10th Cir. 1984), *aff'd on other grounds*, 472 U.S. 585 (1985).

facility.[137] Very few decisions requiring a firm to share facilities, however, have actually rested upon the essential facilities doctrine. Indeed, one commenter suggested that *MCI Communications Corp. v. American Telephone and Telegraph Co.* is the only in the past half century to impose liability on the basis of the essential facilities doctrine.[138] Even broadly reading cases, there appear to be relatively few reported decisions in which plaintiffs have prevailed under the doctrine.[139]

Some commentators have endorsed the doctrine as enhancing competition and consumer welfare.[140] Professor Pitofsky, for example, explains that the doctrine is a sensible exception to the principle that generally companies are free to determine with whom they will deal. The doctrine prevents companies with a monopoly in one stage of production from extending their

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137 *See Intergraph Corp. v. Intel Corp.*, 3 F. Supp. 2d 1255 (N.D. Ala. 1998), *rev'd*, 195 F.3d 1346 (Fed. Cir. 1999); *see also Bellsouth Advertising v. R.J. Donnelley Inf. Pub.*, 719 F. Supp. 1551 (S.D. Fla. 1988), *rev'd on other grounds*, 999 F.2d 1436 (11th Cir. 1993) (subscriber list). *But see Twin Laboratories*, 900 F.2d 566 (rejecting claim that advertising space in magazine was an essential facility because plaintiff could not establish a "severe handicap" to its business resulting from the refusal).

138 *See* USTA Comments, at 17 ("The *MCI* case might be the only one in which liability was ultimately based upon [the essential facilities doctrine]." (citing 708 F.2d 1081)); *see also* IBA Comments, at 7 ("In the United States, the [Essential Facilities doctrine] seems to have been called into play only once in the past thirty years.").

139 *See, e.g., Delaware & Hudson Ry.*, 902 F.2d at 179-80 (reversing grant of summary judgment for defendant on essential facilities and other monopolization claims); *Fishman*, 807 F.2d at 539-41; *Hecht*, 570 F.2d at 992-993 (reversing judgment for defendants on essential facilities and other claims and remanding for new trial). One scholar reports that, between 1980 and 2000, 71 appellate and district court cases expressly passed on claims involving the essential facilities doctrine. Of these, 11 decisions held for plaintiffs; most involved a motion to dismiss or motion for summary judgment. *See* Glenn O. Robinson, *On Refusing To Deal With Rivals*, 87 Cornell L. Rev. 1177, 1207 n.129 (2002) ("Robinson, *Rivals*"). In at least one of these cases, the plaintiff also prevailed under general monopolization principles. *See Delaware & Hudson Ry.*, 902 F.2d at 178-79 (reversing grant of summary judgment on plaintiff's separate claim of monopolization).

140 *See* Pitofsky, *Essential Facilities*, at 452.

monopoly into another stage of production of a product.[141] By preventing such action, the doctrine helps preserve competition.[142] Moreover, Pitofsky argues that it also creates incentives for innovation in the complementary market by preventing a monopolist in the first market from expanding its dominance into the second market.[143] Another commentator has argued that the doctrine, narrowly defined, provides better guidance and is more appropriate to apply than more vaguely delineated standards governing refusals to deal.[144]

The essential facilities doctrine has also been criticized. In particular, critics have argued that the doctrine should not be interpreted to impose duties to deal over and above those duties already otherwise implied under Section 2.[145] The following are some criticisms of the doctrine.

- To the extent the definition of "facility" is not reasonably bounded, the doctrine threatens to overwhelm general Section 2 standards governing unilateral refusals to deal and cause uncertainty.[146]

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141 *Id.*

142 *Id.*

143 *Id.*

144 *See* Robinson, *Rivals*, at 1203 (emphasis in the original); *id*. at 1200-03 (arguing that the current standards governing refusals to deal are far more vague and far reaching than the essential facilities doctrine as actually applied in the lower courts).

145 *See* Pate Statement, at 12-13 ("the notion that 'essential facilities' provides a stand-alone basis for liability is thoroughly discredited."); Shapiro Statement, at 7 ("I am unable, however, to see any basic economic distinction between vertical refusal to deal cases involving a critical upstream input and cases involving an 'essential facility.'"); *see also* Hovenkamp, *Antitrust Policy*, 309-14 ("The so-called essential facilities doctrine is one of the most troublesome, incoherent and unmanageable of bases for Sherman § 2 liability. The antitrust world would almost certainly be a better place if it were jettisoned, with a little fine tuning of the general doctrine of refusal to deal to fill any gaps."); *id*. at 313 (opining that general doctrine governing refusals to deal is adequate to govern so-called "essential facilities" claims); Abbott B. Lipsky, Jr. and J. Gregory Sidak, *Essential Facilities*, 51 Stanford L. Rev. 1187 (1999); Areeda, *Essential Facilities*, 58 Antitrust L.J. 841; Michael Boudin, *Antitrust Doctrine and the Sway of Metaphor*, 75 Geo. L.J. 395, 397-403 (1987) ("Boudin, *Sway of Metaphor*").

146 *See* Areeda, *Essential Facilities*, at 844 (anything one has that another wants may be called an "essential facility"); Shapiro Statement, at 7 ("I am unable, however, to see any basic economic distinction between vertical refusal to deal cases involving a critical upstream input

- Without a definition that distinguishes "facilities" in a meaningful economic way from other inputs subject to monopolization, the existence of a free standing essential facilities doctrine may result in liability distinctions based upon "formalistic line drawing," rather than economic substance.[147]

- Improperly applied, the doctrine can undermine the incentives of monopolists to invest in such infrastructure in the first place.[148]

- As with refusals to deal generally, compulsory sharing requires courts to determine the price at which the monopolist must share, thereby transforming an antitrust court into a price regulator, a status for which courts are not well-suited.[149]

Several AMC witnesses and commenters argued that the essential facilities doctrine should not constitute a free-standing basis for liability under Section 2. Rather, they argue that such claims should be governed by the standards governing refusals to deal generally.[150]

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and cases involving an essential facility . . . If we assume that independent service organizations could not obtain Kodak parts from any source but Kodak, and yet those parts are required to service Kodak copiers, those parts constitute an essential facility in economic if not legal terms."); Hovenkamp, *Antitrust Policy*, at 313; *see also* Boudin, *Sway of Metaphor*, at 401 (explaining that firms obtain monopolies in any number of ways, suggesting that a one sentence formulation cannot capture the various policy questions subsumed with essential facilities analysis).

147 *See* Hovenkamp, *Antitrust Policy*, at 313 ("One problem with the logic of the "essential facility" doctrine is that, if the doctrine is restricted to refusals calculated to create or perpetuate monopoly power, then the more general antitrust rules respecting refusals to deal seem quite adequate to do the job.").

148 *See* Chamber of Commerce Comments, at 9-10 (criticizing essential facilities on these grounds and calling for abolition of the doctrine); Hovenkamp, *Antitrust Policy*, at 313 (criticizing doctrine on this ground); Boudin, *Sway of Metaphor*, at 401; Areeda, *Essential Facilities*, at 851.

149 *See* Chamber of Commerce Comments, at 10 (criticizing doctrine on this ground); Hovenkamp, *Antitrust Policy*, at 313-14 (same); *see also* Areeda, *Essential Facilities*, at 853 (courts should not impose a duty to deal that would require continued supervision of the terms of dealing); *id*. (imposition of duty to deal may be appropriate when "a regulatory agency already exists to control the terms of dealing").

150 *See* Pate Statement, at 12-13; Trans. at 109 (Pate); Shapiro Statement, at 7 (no meaningful distinction between an essential facility and other products over which a defendant has monopoly power); Chamber of Commerce Comments, at 9-10 (calling for abolition of the doctrine); USTA Comments, at 17-18 (essential facilities claims should be subject to the same standards are ordinary refusal to deal claims); *see also Trinko Amicus* Brief, at 20-25 (essential

One witness and several commentators recommended that the doctrine should be retained.[151] One commenter (the American Antitrust Institute) suggested that the essential facilities doctrine should operate as a narrow, well-defined subset of the duties implied by general refusal to deal standards.[152] AAI suggested that the term "essential facility" should apply to "large infrastructure possessed of an element of a public good, such as stadiums, communications networks, transmission grids, etc."[153]

D. What should be the standards for determining when a firm's product bundling or bundled pricing violates Section 2 of the Sherman Act?

"Bundling" entails the sale of two or more products as a "package." Bundling can take two forms. Where the products in question are sold only as part of a package, then the bundling is said to be "pure." Where, on the other hand, the products in the bundle are also sold separately, then the bundle is said to be "mixed."[154] Such mixed bundles may induce purchasers

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facilities label does not obviate requirement that plaintiff demonstrate "exclusionary conduct" under ordinary Section 2 standards); *id.* at 22 & n.6 ("The four factors identified in MCI and other decisions thus are relevant but neither necessary nor sufficient to establish Section 2 liability. As one court has explained, the essential facilities doctrine is a label that may aid in the analysis of a monopoly claim, not a statement of a separate violation of law.") (*quoting Viacom Int'l, Inc. v. Time, Inc.*, 785 F. Supp. 371, 376 n.12 (S.D.N.Y. 1992)).

151 *See* Trans. 111-12 (Pitofsky); AAI Comments, at 22-23 (calling for retention of a narrowly defined essential facilities doctrine); IBA Comments, at 8-9 ("a narrowly-defined essential facilities doctrine, while almost certainly rarely called into play, nonetheless can support dynamic competition"); CompTel Comments, at 6-7 (contending that the essential facilities doctrine "constitutes a sound policy basis for liability"); Western Coal Comments, at 9-11 (endorsing essential facilities doctrine articulated in *MCI*).

152 *See* AAI Comments, at 21-23.

153 *Id.* at 23. The AAI did not explain why property from which owners can exclude others "possesse[s] elements of a public good," or otherwise expand upon this definition. *See generally* Mancur Olsen, *The Logic of Collection Action* (1965) (public goods characterized by non-excludability and nonrivalrous consumption).

154 One commentator has adopted the terms "forced" bundling and "optional" bundling. *See* Barry J. Nalebuff, *Bundling as a Way to Leverage Monopoly*, Yale School of Management, Working Paper ES-36, at 4 (Sept. 1, 2004) ("Nalebuff, *Bundling*").

to choose the entire package, when they might otherwise have chosen to purchase only one part of the package.[155]

Several AMC witnesses and commenters testified that bundling often enhances competition and thus economic welfare.[156] As one witness testified, "[b]undled discounts are a ubiquitous phenomenon in our economy."[157] Because bundling often has procompetitive and proconsumer benefits, even when used by non-monopolists, these witnesses argued that antitrust law should not too readily condemn such practices when used by monopolists.[158]

Witnesses and commenters identified the following procompetitive benefits of bunding:

- Selling products as a package may reduce a manufacturer's costs, and the bundled discount may simply pass these reductions on to purchasers.[159]

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[155] In addition, some companies offer "loyalty discounts." For conceptual clarity, this memorandum treats loyalty discounts to be discounts offered for bulk purchases of the same product. That is, a seller offers to sell multiples of the same product to a customer for a lower per-unit price than for which he would sell a single unit. Pure loyalty discounts are generally lawful in the same manner that above-cost pricing is generally lawful. *See Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1060-63 (8th Cir. 2000). Accordingly, this memorandum addresses loyalty discounts that result from a multi-product bundle within the context of bundling generally.

[156] *See, e.g.*, Muris Statement, at 2-5 (describing numerous instances of benign or procompetitive bundling); Pate Statement, at 15-16; Trans. at 110 (Pitofsky) ("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."); *see also* David S. Evans and A. Jorge Padilla, *Designing Antitrust Rules For Assessing Unilateral Practices*; *A Neo Chicago Approach*, 72 U. Chi. L. Rev. 73, 90 (2005); Daniel Crane, *Multiproduct Discounting*; *A Myth of Non-Price Predation*, 72 U. Chi. L. Rev. 27, 39-43 (2005) ("Crane, *Multiproduct Discounting*").

[157] Trans. at 102-03 (Muris) ("Bundled discounts are a ubiquitous phenomenon in our economy, as I think we all know. . . . 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 efficiency explanations that apply in competitive markets don't also apply in *competitive* markets don't also apply to firms with large market shares.").

[158] *See* Trans. at 103 (Muris).

[159] *See* Business Roundtable Comments, at 25 ("Bundling increases economies of scale, is an important mechanism for controlling costs, consolidates costs for advertising and promotion for new products, generate discounts for consumers, and reduces transaction costs between producers and consumers."). *But see* Tom Statement, at 6 ("It is less than clear, however, that a

- A firm selling a product in one market may employ a bundling strategy as a means of encouraging consumers in another market to try a new product.[160]

- Bundling may help a firm with a monopoly over one product realize economies of scale in the production of another.

- Bundled discounts may help manufacturers reduce transaction costs, by compensating retailers who refrain from opportunistic behavior.[161]

In certain circumstances, however, firms may be able to employ bundling to obtain or maintain a monopoly by excluding rivals on some basis other than efficiency.[162] There are three basic theories as to how bundling can potentially be anticompetitive: (1) as a form of predatory pricing; (2) as a *de facto* form of tying; and (3) as exclusionary conduct in the form of deterring entry.[163]

- *Predatory pricing*. By providing bundled discounts, a dominant firm may, by sacrificing short-term profits, force its competitors to sell at an unprofitable

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bundled discount necessarily results in a price decrease to every consumer in every case. In many cases the "discount" is off of a price for the monopolized product that is above the level that is monopoly-profit maximizing had there been no bundle.").

160 *See* Muris Statement, at 4.

161 *See id.* at 17.

162 *See* Shapiro Statement, at 17-18 ("One can construct economic models in which a dominant firm selling multiple products can profitably employ multi-product discounts to drive its smaller rivals from the market and then recoup those discounts in the form of higher prices."). *But see* Muris Statement, at 16-17 (discussing shortcomings of models that purport to show that bundling can produce harms); *id*. at 22 ("empirical support for the anticompetitive hypothesis is virtually non-existent").

There is some debate as to whether bundling should be considered unilateral conduct, governed by Section 2 or concerted action, comparable to tying, and thus analyzed as a potential Section 1 violation. For instance, Professor Hovenkamp argues that the "real gravamen of the offense" in *Lepage's* was "tying rather than predatory pricing" and that "such cases should be addressed under the law of tying arrangements, and not under the law of predatory pricing." *See* Hovenkamp, *Antitrust Policy*, at 317; *see also* Pitofsky Statement, at 6 ("Such cases can be brought as tie-in sales under Section 3 of the Clayton Act but are more usually brought under Section 2 of the Sherman Act."); *cf*. 15 U.S.C. § 14 (Section 3 of the Clayton Act) (prohibiting the granting of a discount "on the condition, agreement, or understanding" that the purchaser not purchase or lease the goods of another ").

163 *See* Muris Statement, at 12-18; Daniel Rubinfeld, *3M's Bundled Rebates: An Economic Perspective*, 72 U. Chi. L. Rev. 243, 254-61 (2005) ("Rubinfeld, *Bundled Rebates*").

price.[164] In this sense, bundling is essentially the same as predatory pricing, where a monopolist incurs a present loss in the expectation that it will recoup its short-term sacrifices by using its increased market power to capture monopoly profits in the long run.[165]

- De facto *tying*. In lieu of a contractual tie-in (requiring purchase of both products A and B), a dominant firm may offer an attractive bundled price, with individual product prices set unattractively high, so that the purchase of both products is made more attractive than purchasing only one of the products.[166] The firm is thereby able to hide an increase in the price paid for its monopoly good.[167]

- *Creation of Entry Barriers*. A dominant firm might use bundling to erect entry barriers or otherwise foreclose competition. By providing bundled discounts that reduce the price (net of discounts) of the competing good, a competitor who produces only that good may not be able to compete effectively because the competitor must also be able to offer for sale the monopoly good.[168]

Despite the ubiquity of bundling, there is a paucity of case law addressing the practice.[169] The most prominent, and most recent, appellate decision is the Third Circuit's recent decision in *LePage's v. 3M*.[170] AMC witnesses and commenters were nearly unanimous in criticizing the Third Circuit's treatment of bundling in *LePage's*.[171] Several criticized the opinion for failing to

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164 Muris Statement, at 12; Rubinfeld, *Bundled Rebates*, at 254-56.

165 Muris Statement, at 12.

166 *See id.* at 14.

167 *Id.* This theory relies on the "one monopoly rent" theory not applying to the behavior. *See* Patrick Greenlee, David Reitman, and David S. Sibley, *An Antitrust Anaylsis of Bundled Loyalty Discounts*, Economic Analysis Group Discussion Paper EAG 04-13 (Oct. 2004), at 12; *see also* Salop Statement, at 3 (listing circumstances in which one monopoly rent, or "single monopoly price" ("SMP") does not apply).

168 *See* Rubinfeld, *Bundled Rebates*, at 256-58; Muris Statement, at 16.

169 *LePage's v. 3M*, 324 F.3d 141 (3d Cir. 2003) (*en banc*); *SmithKline Corp. v. Eli Lilly & Co.*, 427 F. Supp. 1089 (E.D. Pa. 1976), *aff'd*, 575 F.2d 1056 (3d Cir. 1977); *Virgin Atlantic Airways Ltd. v. British Airways, PLC*, 69 F. Supp. 2d 571, 580 (S.D. N.Y. 1999); *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996).

170 324 F.3d 141.

171 *See* Pitofsky Statement, at 8 (*Lepage's* took a "different approach" from the "sensible rule" applied by other courts, with the result that "it is unfortunate that the Supreme Court declined to review that particular case"); Pate Statement, at 14 ("Any objective basis for decision would be better than the absence of such a basis reflected in *LePage's*."); Shapiro Statement, at

require the plaintiff to demonstrate that it was as efficient as the defendant or that the bundled pricing would have excluded an equally efficient rival.[172] As a result, they argue, the rule of *LePage's* is substantially likely to generate false positives, protecting inefficient rivals and chilling conduct that enhances economic welfare.[173] Some also noted that the opinion imposes no requirement that a plaintiff demonstrate that the monopolist can recoup whatever profits it might sacrifice through its bundling strategy.[174] Finally, some witnesses and commentators also

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17-18; Trans. at 121 (Shapiro) ("I think *Lepage's* is a problem."); Muris Statement, at 9-12; Popofsky Statement, at 11-12; IBA Comments, at 19 ("*Lepage's* was fundamentally flawed as a statement of the appropriate rule"); Business Roundtable Comments, at 24-25; *see also* ICC Comments, at 16 (stating that *Lepage's* may have the effect of discouraging pro-consumer price competition). *But see* AAI Comments, at 23-25 (endorsing *LePage's*); *id.* at 25 ("The *LePage's* litigation is exemplary of how antitrust courts are capable of arriving at reasonable and predictable conclusions using common law principles based on sound economic intuition.").

172 *See* Muris Statement, at 10 (The Third Circuit did not require LePage's to prove that it could make tape as efficiently as 3M, or that 3M's conduct would have excluded a hypothetically equally efficient competitor); Pate Statement, at 14 ("The Third Circuit neither required LePage's to show that it was unable to make offers comparable to 3Ms nor that it would have been impossible for an equally efficient rival to compete with 3M's offers."); Popofsky Statement, at 10-11; *see also* Business Roundtable Comments, at 25 ("The decision in *LePages* is inconsistent with sound antitrust policy because it protects competitors rather than considering effects on competition in the market and consumers."); IBA Comments, at 20 (contending that it was a "mistake" for *Lepage's* court not to require a showing that the plaintiff could not rationally match 3M's discounts).

173 *See* Muris Statement, at 11 ('liability rules [like the one in *LePages*] based on speculative theories of harm applied to a ubiquitously-used practice will likely result in widespread false positives that condemn efficient practices."); Pate Statement, at 15-16 ("the Third Circuit's opinion provides a firm with market power that seeks to offer bundled discounts no way to do so without running a significant risk of Section 2 liability. The court's failure to make clear what showing or showings are necessary of sufficient for imposing liability for bundled rebates or exclusive dealing under Section 2 is regrettable."). The dissent leveled a similar critique. *See LePage's*, 324 F.3d at 177 (Greenberg, J. dissenting) ("LePage's economist conceded that LePage's is not as efficient a tape producer as 3M. Thus in this case section 2 of the Sherman Act is being used to protect an inefficient producer from a competitor not using predatory pricing but rather selling above cost.").

174 Trans. at 70-71 (Rule) (criticizing *Lepage's* on these grounds).

opined that, regardless of its content, the rule is too vague.[175] Such vagueness, they argue, may itself chill some welfare-enhancing conduct.[176] Several scholars have leveled similar criticisms at the decision.[177]

Given these criticisms, witnesses and commentators suggested that the Commission recommend that courts articulate a safe harbor to govern Section 2 scrutiny of bundling by monopolists. In particular, a safe harbor requiring plaintiffs to establish that the prices charged under the challenged bundling plan fell below some measure of cost.[178] These witnesses proposed that such a test would be a "necessary condition" for liability.[179] At the very least, several said, plaintiffs should also have to establish the conditions necessary for recoupment of

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175 *See* Muris Statement, at 11-12; Pate Statement, at 15-16; Business Roundtable Comments, at 24 ("[LePages] creates considerable uncertainty about the circumstances under which a firm may offer 'bundled' pricing and other 'above cost' discounts to its customers. This uncertainty may discourage firms, including Roundtable members, from engaging in discounting activities that benefit consumers. It also complicates internal risk assessment for firms and increases the cost of antitrust counseling."). *But see* AAI Comments, at 25 (concluding that the outcome in *Lepage's* was "reasonable and predictable").

176 Business Roundtable Comments, at 24.

177 *See, e.g.*, Crane, *Multiproduct Discounting*, at 38-48; Richard E. Epstein, *Monopoly Dominance or Level Playing Field? The New Antitrust Paradox*, 72 U. Chi. L. Rev. 49, 68-71 (2005); Rubinfeld, *Bundled Rebates*, at 254-62.

178 *See* Trans. at 39-40 (Tom) ("[C]ertainly 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."); Muris Statement, at 23-27; Trans. at 52 (Popofsky); Trans. at 111 (Pitofsky); Shapiro Statement, at 18; Business Roundtable Comments, at 24-25; IBA Comments, at 19; *see also* Pate Statement, at 16-17 (suggesting that a cost-based safe harbor may have been superior to the approach taken in *LePage's*). Professor Salop expressed concern that monopolists could circumvent a cost-based test by manipulating the benchmark against which such a test was applied. *See* Trans. at 72. Nonetheless, he seemed to endorse the test as a matter of theory. *See id.*; *see also* Trans. at 82 (Salop).

179 *See* Pate Statement, at 17 (price-cost test should operate as a necessary but not sufficient condition for liability); Shapiro Statement, at 18 ("Of course, even multi-product pricing structures that fall outside the safe harbor may well be procompetitive or competitively neutral.").

the monopolist's investment in the scheme.[180] Some also suggested that courts require an additional showing that the purportedly excluding rival could not rationally match the challenged discounts or allow defendants to adduce proof that the bundle produces benefits not reflected in the defendant's production costs.[181]

The approach urged by most of the hearing witnesses and commentators was an incremental cost versus incremental revenue test.[182] Under this test, comparable to those adopted by two decisions in the Southern District of New York, courts would attribute all discounts paid under the plan to the bundled product. Courts would then ask whether the price of the bundled product, adjusted to reflect these discounts, exceeded the defendant's average variable costs of producing the bundled product.[183]

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[180] Shapiro Statement, at 18 ("Plaintiffs would still have to show that the structure employed was likely to harm consumers, presumably based on some sort of exit and recoupment logic, just as in conventional predatory pricing cases."); Muris Statement, at 20-21; Tom Statement, at 8-9 (endorsing requirement that market from which rival is purportedly excluded be characterized by economies of scale that prevent reentry); Trans. at 39-40 (Tom) (adding requirement of sunk costs); Trans. at 70-71 (Rule); IBA Comments, at 16, 22-23.

[181] *See, e.g.*, IBA Comments, at 20-21 (courts should also ask whether the injured rival can rationally match the challenged discounts); *see also* Muris Statement, at 17 (explaining that bundling that seems to exclude equally efficient rival may in fact be a means of reducing transaction costs). If, as Professor Muris suggests, bundling can reduce transaction costs, proof of "below cost" pricing plus the prospect of recoupment should simply shift to the defendant the burden of establishing such a beneficial impact.

[182] *See* Shapiro Statement, at 18; IBA Comments, at 18-19; Trans. at 52 (Popofsky). Professor Pitofsky suggested that court prorate the total discount and allocate an equal share to each of the products in the bundle, then asking whether any product was sold below cost. *See* Trans. at 111 (Pitofsky).

[183] *See* Shapiro Statement, at 18; Tom Statement, at 9 (explaining that focus on defendant's costs is equivalent to a hypothetical equally efficient rival test); *see also Virgin Atlantic Airways Ltd. v. British Airways PLC*, 69 F. Supp. 2d 571, 580 (S.D.N.Y. 1999) ("the competitive product in the bundle [be] sold for a price below average variable cost after the discounts on the monopoly items in the bundle were subtracted from the price of that competitive product."), *aff'd*, 257 F.3d 256 (2d Cir. 2001) (citing *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*, 920 F. Supp. 455, 467-69 (S.D.N.Y. 1996)).

One hearing witness and commentator urged a different test—one that would require the rejection of bundling claims whenever the defendant's revenues derived from the entire bundle exceed the average variable costs of producing the products in the bundle.[184]

Regardless of the precise standard, witnesses and commenters identified the following pros and cons of a cost-based standard:

Pros

- Such a standard minimizes the risk of false positives and thus will chill very little beneficial conduct.[185]
- Such a standard will minimize the cost of compliance by affected monopolists.[186]
- Such a standard will minimize the cost of adjudication and settlement negotiations by simplifying the sort of information that courts and parties must gather to apply it.[187]

Cons

- Such a standard may be under-inclusive, in that it may not interdict instances in which a monopolist employs a bundling strategy to exclude an equally or even more efficient rival.
- Such a standard could induce monopolists to offer products and/or bundles that they might not otherwise offer, thereby distorting the allocation of resources.

E. Should there be a presumption of market power in tying cases when there is a patent or copyright? What significance should be attached to the existence of a

[184] *See* Muris Statement, at 13, 20-27. Under this approach, courts would "allow bundled discounts so long as the price of the bundle exceeds the sum of the separate costs of the constituent elements. Put another way, if the total price of the bundle exceeds the total cost of its constituents (taking into account the efficiencies directly attributable to bundling), the firm has not engaged in predatory bundling." *See id.* at 13; *see also* Trans. at 137 (Muris) (acknowledging, but rejecting, criticism that using total cost disregards effect of bundling).

[185] *See id.* at 25-26; *id*. at 26 ("It is especially difficult to distinguish instances of anticompetitive bundling from cases of procompetitive bundling.").

[186] *See id.* at 26.

[187] *See id.* at 13-14 (arguing that application of an alternative "incremental cost/incremental revenue" test would require arbitrary allocations of costs to various products and constitute an "administrative nightmare" for courts).

patent or copyright in assessing market power in tying cases and in other contexts?

The legal landscape has changed since the issue noted in the heading to this section was adopted for study by the Commission. In *Illinois Tool Works v. Independent Ink*, the Supreme Court reversed a Federal Circuit decision adhering to previous Court precedents that provided for a presumption of market power.[188] The Court unanimously held that "a patent does not necessarily confer market power upon a patentee" and that, "in all cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product."[189]

In reaching this decision, the Court reviewed the history of tying law generally and its application in cases involving intellectual property in particular. It explained that the presumption originated in patent misuse cases involving tying of patented and unpatented goods, and how subsequent cases—particularly *International Salt*[190]—"imported" this doctrine into tying law, in part on the ground that the policy considerations were the same.[191] As a result, the Court had characterized such patent ties as "illegal per se."[192]

The Court explained that its reconsideration of the "presumption of per se illegality of a tying arrangement involving a patented product" was appropriate in light of developments since those earlier rulings. Most important, in 1988 Congress "amended the patent Code to eliminate

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188 *Independent Ink v. Illinois Tool Works*, 126 S. Ct. 1281 (2006), *reversing* 396 F.3d 1342, 1345 (Fed. Cir. 2005).

189 126 U.S. at 1293. Justice Alito did not participate.

190 *International Salt Co. v. United States*, 332 U.S. 392 (1947).

191 126 U.S. at 1288-89.

192 *Id.* at 1289 (quoting *United States v. Columbia Steel Co.*, 334 U.S. 495, 522-23 (1948)).

[the market power] presumption in the patent misuse context."[193] After considering "the congressional judgment reflected" in this amendment, the Court concluded that ties involving patented products should be treated like other ties, and not be condemned without a showing of market power.[194] The Court also observed that imposing this requirement was supported by "the vast majority of academic literature" addressing the question and by "a virtual consensus among economists" on this matter.[195] Furthermore, it noted, the federal antitrust enforcement agencies' *Intellectual Property Guidelines* provide that the agencies "will not presume that a patent, copyright or trade secret necessarily confers market power upon its owner."[196]

Respondents in *Independent Ink* argued in the alternative that the Court should adopt a rebuttable presumption, arguing that patents that are used to impose ties "likely do exert significant market power."[197] Alternatively, they suggested that the Court should recognize a rebuttable presumption of market power when an unpatented product is purchased over time (rather than purchased simultaneously with the tied product).[198] The Court rejected these

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193 *Id.* at 1290.

194 *Id.* at 1291. Indeed, the Court's statement suggests that rule of reason treatment may well be required in tying cases. "[W]e conclude that tying arrangements involving patented products should be evaluated under the standards applied in cases like *Fortner II* and *Jefferson Parish* rather than under the per se rule applied in *Morton Salt* and *Loew's*. While some such arrangements are still unlawful, such as those that are the product of a true monopoly or a marketwide conspiracy, *see, e.g., United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 145-146 [] (1948), that conclusion must be supported by proof of power in the relevant market rather than by a mere presumption thereof."). 126 U.S. at 1291 (footnote omitted).

195 126 U.S. at 1291 n.4, 1292.

196 126 U.S. at 1292 (quoting U.S. Dept. of Justice & Fed'l Trade Comm., *Guidelines for the Licensing of Intellectual Property* § 2.2).

197 126 U.S. at 1291.

198 126 U.S. at 1291-92.

alternatives, observing that many tying arrangements "are consistent with a free, competitive market."[199]

Consistent with the "virtual consensus" the Court identified in *Independent Ink*, witnesses at the AMC's hearing (which took place before *Independent Ink* was decided) were united in their opposition to the market power presumption.[200] Similarly, a number of commenters argued that there should be no presumption of market power from patents or copyrights.[201] Thus the AMC's witnesses and commenters generally advocated what is now the state of the law.

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[199] 126 U.S. at 1292.

[200] Trans. at 41-42 (no disagreement from panelists with observation that they appeared "unanimous in saying that the mere fact that you have a patent shouldn't give the presumption of market power); *see also* Statement of James J. O'Connell on Behalf of the United States Department of Justice, at 3 (Nov. 8, 2005) ("there should not be a presumption of market power in tying cases when there is a patent" (citing Brief for the United States as Amicus Curiae Supporting Petitioners, Illinois Tool Works Inc. v. Independent Ink, Inc. (No. 04-1329), *cert. granted*, 73 U.S.L.W. 3729 (June 21, 2005); Carl Shapiro, Antitrust, Innovation, and Intellectual Property, at 7-8 (Nov. 8, 2005) ("[m]any patents are "of limited commercial significance" and "many copyrights merely allow their owners to differentiate their products" from others); Richard J. Gilbert, New Antitrust Laws for the "New Economy"?, at 10-11 (Nov. 8, 2005) ("There should be no presumption that a patent or copyright is a source of market power in tying cases or in other antitrust contexts.").

[201] *See* Comments of the Motion Picture Association of America, at 3-4 (stating that "the great weight of analysis and opinion" opposes the presumption, citing numerous authorities); Letter from Daniel G. Swanson to Andrew J. Heimert (Aug. 9, 2005) (attaching amicus brief of the Motion Picture Association of America in *Independent Ink* in support of petitioners); Comments of the American Intellectual Property Law Association, at 1-3 (urging that the AMC recommend Congressional action to eliminate the presumption if the Supreme Court does not do so); Comments of the Computer & Communications Industry Association, at 12 (a presumption is "unnecessary").