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July 15, 2005

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Ms. Deborah A. Garza
Chair
Antitrust Modernization Commission
Attn: Public Comments
1001 Pennsylvania Avenue, N.W.
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RE: Comment Regarding Issues Accepted for Study and Consideration: Refusals to Deal and the Essential Facilities Doctrine.

Dear Deb:

On behalf of the United States Telecom Association and its member companies, I am submitting the attached comments in response to the Commission's May 19, 2005 Federal Register Notice soliciting comments from the public on certain antitrust issues. 70 Fed. Reg. 28,902. The attached comments address the first two questions posed by the Commission in Section IV of its Notice (Exclusionary Conduct), specifically those referring to refusals to deal and the essential facilities doctrine. They also address in part the final question in Section IV as to whether judicial development or legislation is the best means to determine antitrust standards in this area.

I hope to be able to discuss the issues addressed in these comments at the appropriate public meeting of the Commission.

Sincerely,

Doug Melamed / jn

A. Douglas Melamed

Attachment

COMMENTS ON

REFUSALS TO DEAL AND THE ESSENTIAL FACILITIES DOCTRINE

SUBMITTED ON BEHALF OF THE

UNITED STATES TELECOM ASSOCIATION

IN RESPONSE TO THE REQUEST OF THE ANTITRUST MODERNIZATION COMMISSION FOR COMMENTS REGARDING EXCLUSIONARY CONDUCT

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July 15, 2005

These comments are submitted on behalf of the United States Telecom Association (USTelecom) and its member companies in response to the May 19, 2005 Federal Register Notice soliciting comments from the public on antitrust issues accepted for study and consideration by the Antitrust Modernization Commission. 70 Fed. Reg. 28,902.[1] The comments presented here focus on the first two questions posed by the Commission in Section IV ("Exclusionary Conduct") of its Notice: whether and when Section 2 of the Sherman Act, 15 U.S.C. § 2 (2005), should be applied to impose liability for a monopolist's unilateral refusal to deal with its rivals, either under the "essential facilities" doctrine articulated by some lower courts or under the more general doctrines of "exclusionary conduct" or "illegal monopolization."[2] Our answers to those questions effectively answer the final question in Section IV as well: In our view, judge-made antitrust law in this area is developing properly, and no legislative or regulatory intervention is needed to improve upon it.

SUMMARY

Antitrust minimalists argue that a monopolist's refusal to deal with rivals should never be deemed to violate Section 2, even when the refusal is anticompetitive and has no efficiency justification. In contrast, antitrust activists argue that courts should readily invoke Section 2 to require monopolists to sell "essential" inputs to rivals, even though that approach would deny firms the fruits of lawfully gained monopolies and would produce reduced investment incentives, inhibitions on efficient competition, and substantial transaction costs.

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1 USTelecom is the nation's leading trade association representing communications service providers and suppliers for the telecom industry. USTelecom's carrier members provide a full array of voice, data, and video services across a wide range of communications platforms.

2 These comments address only general antitrust principles applicable to refusals to deal. They do not address either special issues regarding refusals to deal by firms in regulated industries or the policy choices regulators face in considering how to address refusals to deal in such industries.

A prudent antitrust principle has emerged in recent years that steers a sound middle course between these extremes and holds a defendant liable under Section 2 for a unilateral refusal to deal with rivals only when the plaintiff can meet at least four necessary—though not sufficient—conditions. First, the refusal must harm competition in the market as a whole, not just an individual competitor. Second, the defendant must have monopoly power or a dangerous probability of obtaining it in that market. Third, there must be some easily administered means for the court to use in determining the terms, including price, on which the duty to deal will be enforced. Finally, the refusal to deal must make no business sense apart from its tendency to exclude rivals and thereby create or maintain market power. The last two of these conditions must of course be tractable and applied in a way that ensures that refusal-to-deal law not by imprecision or uncertainty attract meritless lawsuits and thus disserve its objective of promoting robust competition and efficiency. The Supreme Court cases finding a duty to deal involved defendants that were voluntarily selling to others what they denied to the plaintiffs on the same terms.

DISCUSSION

In *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), the Supreme Court rejected an antitrust claim based on an alleged duty to deal under Section 2. The Court's decision touched off a wave of criticism by proponents of greater antitrust intervention. These antitrust critics feared that *Trinko* and similar decisions "seriously understate[]" the "price of false negatives, of under-deterrence."[3] This criticism was similar in

[3] Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 Antitrust L.J. 3, 36-51 (2004); *accord* Marina Lao, *Reclaiming a Role for Intent Evidence in Monopolization Analysis*, 54 Am. U. L. Rev. 151 (2004); *see also* Steven C. Salop & R. Craig Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft*, 7 Geo. Mason L. Rev. 617 (1999).

form to, though of course very different in substance from, concerns voiced on the other side—by skeptics of antitrust intervention—about false *positives* and *over*-deterrence in the wake of the government's successful litigation against Microsoft for violations of Section 2.[4]

As discussed below, however, the decisions in *Trinko* and *Microsoft* are entirely consistent with each other and with sound application of Section 2. Both decisions, and the principles they embrace, occupy a sensible middle ground between minimalism and interventionism in antitrust. Those principles give effect to Section 2 in the refusal-to-deal context while avoiding the risk of the widespread false positives that would otherwise threaten the basic pro-competitive objectives of the Sherman Act.

I. THE NATURE OF THE PROBLEM

A. THE COSTS AND BENEFITS OF AN ANTITRUST DUTY TO DEAL

The refusal-to-deal issue arises principally when a single firm unilaterally chooses not to sell an input to a rival that requests it.[5] In *Trinko,* for example, the issue arose because a putative monopolist in the local exchange market—Verizon—was alleged not to have made certain wholesale ordering systems sufficiently available to rivals that claimed a need to use them in order to provide competing telephone services over Verizon's network.

Whenever a firm, including a monopolist, makes a unilateral decision not to provide an input to a rival, imposing a duty to deal under the antitrust laws would impose significant economic costs. First, because the refusing firm can be deemed to know best how to profit from its own property, such forced dealing would necessarily reduce the value of that property to the

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4 *See United States v. Microsoft,* 253 F.3d 34 (D.C. Cir.), *cert. denied,* 534 U.S. 952 (2001).

5 These comments do not address concerted refusals to deal by multiple parties. *See, e.g., United States v. Terminal Railroad,* 224 U.S. 383 (1912).

refusing firm. Forced dealing thus inevitably implicates the core antitrust principle that all firms, even those with market power, should be free to enjoy the fruits of their "skill, foresight and industry," *United States v. Aluminum Co. of America*, 148 F.2d 416, 430 (2d Cir. 1945), and their "superior product [and] business acumen." *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

Second, as the *Trinko* Court pointed out, forcing monopolists "to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in . . . economically beneficial facilities." 540 U.S. at 407-08; *see also United States Telecom Ass'n v. FCC,* 359 F.3d 554 (D.C. Cir.), *cert. denied*, 125 S. Ct. 313 (2004); *AT&T Communications of Ill., Inc. v. Ill. Bell Tel. Co.*, 349 F.3d 402, 404 (7th Cir. 2003) (Easterbrook, J.); Richard A. Posner, *Natural Monopoly and Its Regulation* (Cato Inst., Washington, DC, reprinted 1999). Any established firm will have less reason to make sunk investments in risky new ventures if it knows that it may need to share any upside potential of those investments with rivals while bearing by itself the downside risk that the ventures will fail. Likewise, the rivals themselves will be less likely to make such investments on their own if they can rely instead on a government-created option to share in the successful ventures of an established firm, accompanied by no corresponding obligation to share in the losses of that firm's unsuccessful ventures.[6]

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[6] Theoretically, in a world of omniscient regulators, these disincentives could be mitigated by adjusting the price a rival must pay for the input to account for the riskiness of the underlying investment—*e.g.*, through a risk-adjusted "cost of capital"—and the "option value" to the rival of purchasing the input from the incumbent only if it pans out. But the task of setting prices at the "right" level to reflect such amorphous considerations—and constantly fine-tuning them as the market evolves—is indeterminate enough even when undertaken by expert regulatory agencies (and is particularly unlikely to succeed, given the generally short-term focus of regulators on ensuring low rates). Antitrust courts are even less suited to assume that role.

Third, the costs of requiring a firm to deal with its rivals are qualitatively different from, and potentially greater than, the costs imposed by most other forms of antitrust intervention. A healthy economy depends on the commitment of mutually antagonistic market actors to compete vigorously for market share. Perhaps more than any other antitrust requirement, forcing a firm to help its rivals (and thereby undermine its own bottom line) would cut against the grain of this most essential of all capitalist instincts. The unintended consequences of such a duty, if broadly enforced, would range from excessive, efficiency-reducing caution in the pursuit of marketplace success to the facilitation of outright collusion among rivals. *See Trinko,* 540 U.S. at 407-08. Because imposition any duty to deal (as opposed to other antitrust duties) *always* threatens inefficiencies of this type, any such duty should be carefully limited.

Fourth, enforcement of duties to deal can impose substantial administrative and transaction costs on the parties as well as courts and enforcement agencies. Because refusals to deal can take myriad forms and are only rarely amenable to market-based remedies, enforcement of any broad duty to deal under Section 2 would miscast antitrust courts "as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are ill-suited." *Trinko*, 540 U.S. at 408. For that reason, the *Trinko* Court found that such refusals "should be deemed *irremediable* by antitrust law when compulsory access requires the court to assume the day-to-day controls characteristic of a regulatory agency." *Id.* at 415 (quoting Philip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles,* 58 Antitrust L.J. 841, 853 (1989)) (emphasis added; internal brackets omitted).

Such restraint is warranted not just because an antitrust court is likely to make mistakes in individual cases in the course of administering a quasi-regulatory regime, but also because widespread refusal-to-deal litigation, and the uncertain remedies it would spawn, would chill investment and competition in general. Whereas administrative agencies can establish *ex ante* rules that industry actors can follow, and can offer advisory opinions when the rules are unclear, antitrust courts are limited to the *ex post* resolution of specific controversies under broad legal principles. Permitting courts to impose treble damages under Section 2 for refusals to deal, except in well-defined circumstances, would encourage large firms to pull their competitive punches in dealing with rivals even in the broad run of cases where consumer welfare would benefit most from fully adversarial competition.

This is not to say that refusals to deal are costless. For one thing, a refusal to deal is presumably costly to the rival that unsuccessfully seeks to obtain the relevant input from the monopolist. That cost by itself, however, has no antitrust significance, both because the antitrust laws are properly concerned with "the protection of *competition,* not [individual] *competitors,*"[7] and because facilitating the reliance of rivals on a monopolist's assets can reduce their incentives to make efficient investments of their own. Of more interest to antitrust are the costs that can arise when a refusal to deal denies rivals an input essential to effective competition in the market as a whole. This can happen only if (i) the rivals denied the input are needed as market participants in order for there to be effective competition in the market and (ii) they need the input in order to be effective competitors. In these cases, under some circumstances, a refusal to deal can perpetuate monopoly power that would otherwise be eroded or lead to the creation of monopoly power that would otherwise not exist.

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7 *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962)).

B. OPPOSING VIEWS ON DUTIES TO DEAL

These competing concerns present an obvious trade-off. In some areas, Congress has created expert agencies to resolve the duty-to-deal problem on an industry-specific basis. For example, in the telecommunications industry, Congress has directed the FCC to take the economic costs of forced sharing into account by limiting network access obligations under the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996), to those facilities that, for reasons "linked (in some degree) to natural monopoly," rivals genuinely must be able to use in order to compete. *United States Telecom Ass'n v. FCC*, 290 F.3d 415, 427 (D.C. Cir. 2002) (*"USTA I"*). The question here is when *antitrust courts*, despite their lack of industry-specific expertise and other institutional limitations, should independently intervene in the market. Several different answers have been proposed to that question, and they span the spectrum from "never" to "often."

At one pole, antitrust minimalists argue that refusals to deal should *never* be deemed a violation of Section 2. *See, e.g.,* Frank H. Easterbrook, *Information and Antitrust*, 2000 U. Chi. Legal. F. 1 (2000). The argument is that refusals to deal, by firms with or without market power, are ubiquitous and almost always efficient; that antitrust courts cannot accurately enough identify the small class of cases in which a refusal to deal might reduce economic welfare; and that any articulable rule inviting courts to undertake that inquiry carries risks and costs—*e.g.,* the risk of false positives carrying injunctions and treble damages, and the sheer costs of litigating such claims—that, in themselves and because they would deter beneficial unilateral marketplace conduct, exceed the costs of the occasional false negatives under a minimalist approach.

At the other end of the spectrum are those who argue that courts should readily invoke the antitrust laws to require dominant firms to deal with rivals. *See* note 3, *supra.* They advance two basic rationales. The first and most sweeping is that any refusal to deal at a price that exceeds the incremental costs of dealing can reduce consumer welfare. The logic of the argument would all but eliminate monopoly profits because it would entitle a rival to purchase a monopolist's products at cost in order to resell them at a price lower than that charged by the monopolist—and thus to arbitrage away any monopoly profits. The second rationale, basically a form of the "essential facilities doctrine" discussed below, is that a duty to deal should be imposed when necessary to enable competition. Both rationales focus on the short-term costs and benefits of intervention and deemphasize long-term or dynamic considerations, such as concerns about protecting incentives for investment and entrepreneurship, as well as the related principle that firms should be entitled to reap the fruits of their lawfully obtained monopolies.

The minimalist approach might allow anticompetitive refusals to deal that have no plausible efficiency justification. Entrenched monopolists in network industries, for example, might sometimes be able to gain market power, with no offsetting efficiency gains, by selectively refusing to interconnect with rivals. And the minimalist approach might have precluded the Justice Department's case against AT&T, discussed below. *United States v. American Tel. & Tel. Co.*, 552 F. Supp 131 (D.D.C. 1982) (*"AT&T Decree Decision"*), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

The more interventionist alternative presents several different problems. The first and most basic is that, by readily setting aside the monopolist's interest in retaining for itself the benefits of its own property, this approach would undermine incentives for investment and entrepreneurship. As the *Trinko* Court observed:

> 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-market system. The opportunity to charge monopoly prices—at least for a short period—is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth.

540 U.S. at 407. Put differently, U.S. antitrust law embraces a key presumption that the prospect of monopoly profits from lawful monopolies is essential to dynamic efficiency, which is in turn essential to long-run consumer welfare.

The interventionist approach is particularly inimical to dynamic efficiency in high-technology industries. As Richard Posner explains, the "gale of creative destruction that [Joseph] Schumpeter described, in which a sequence of temporary monopolies operates to maximize innovation that confers social benefits far in excess of the social costs of the short-lived monopoly prices that the process also gives rise to, may be the reality of the new economy." Richard A. Posner, *Antitrust in the New Economy,* 68 Antitrust L.J. 925, 930 (2001). Rules that seek indiscriminately to stamp out monopoly pricing would break this engine of economic growth.[8]

The interventionist approach would likewise present the potential for many false positives by subjecting large firms to massive antitrust liability for appropriately vigorous competitive conduct that should be encouraged rather than discouraged. This threat of false positives would create perverse investment disincentives and a debilitating climate of uncertainty within the business community about which forms of competitive conduct will give rise to treble damages. False positives in Section 2 cases are particularly harmful to consumer welfare because their costs, in the form of deterred investment and competition, "are likely to be significantly larger than those of false acquittals." David S. Evans & A. Jorge Padilla, *Designing*

8 *See, e.g.,* F. Scherer, *Innovation and Growth: Schumpeterian Perspectives* vii (1984) ("technological change has had, and will continue to have, much more of an impact on material well-being than the niceties of static resource allocation to which microeconomists devote most of their attention"); J. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress,* 62 N.Y.U. L. Rev. 1020, 1026 (1987) ("technological progress is the single most important factor in the growth of real output in the United States and the rest of the industrialized world").

Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach, 72 U. Chi. L. Rev. 73, 83 (2005).

Indeed, the Supreme Court's antipathy towards interventionist duty-to-deal rules that threaten to erode incentives for robust dynamic competition extends beyond antitrust law—and thus beyond concerns specific to an antitrust court's institutional limitations—to regulatory schemes administered by expert agencies. In *AT&T Corp. v. Iowa Utilities Board,* 525 U.S. 366 (1999), for example, the Court invalidated, for lack of any limiting principle, an FCC rule that essentially entitled new entrants to lease, at cost-based rates, any element of an incumbent's telephone network that they could not obtain as cheaply elsewhere.[9]

II. THE *TRINKO* MIDDLE GROUND

In *Trinko*, the Supreme Court wisely steered a middle course between these two polar alternatives. While it firmly rejected the interventionist approach, the Court did not foreclose the possibility of Section 2 liability for refusals to deal in all circumstances, as the antitrust minimalists have proposed. The essential and welcome message of *Trinko* is that no firm will be held liable for refusing to deal with rivals unless, among other things, its own conduct demonstrates that the refusal does not make business sense except as a means of excluding rivals and thereby obtaining increased market power. *See* 540 U.S. at 408-09.

Although *Trinko* announced no bright-line rules of general application, the Court's analysis in that case, in *Aspen Skiing v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), and

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9 In rejecting a later set of similarly interventionist FCC rules, the D.C. Circuit explained that forcing an incumbent to share its assets with rivals "is not an unqualified good," as the FCC had assumed, and must be carefully circumscribed, because any sharing obligation "comes at a cost, including disincentives to research and development by both [incumbents] and [rivals] and the tangled management inherent in shared use of a common resource." *USTA I,* 290 F.3d at 429.

in other antitrust decisions suggests a sound antitrust principle under which Section 2 liability for a refusal to deal is subject to at least four necessary conditions.[10]

First, the refusal to deal must materially impair competition in a relevant market. This requires both (i) that the refusal to deal denies rivals inputs that they need in order to compete against the defendant and (ii) that rivals that need the inputs are themselves needed for competition in the market as a whole. The first of these elements means that the refusal to deal must really matter and that it must be very difficult to transact around; the second ensures that the refusal causes harm to *competition*, not just to particular *competitors*. *See, e.g., Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.,* 429 U.S. 477, 488 (1977).

Second, the defendant must have monopoly power or a dangerous probability of obtaining it in the market from which rivals are excluded. This condition is necessary to meet the statutory requirements of Section 2. *See Spectrum Sports, Inc. v. McQuillan,* 506 U.S. 447, 455-56 (1993); *Grinnell Corp.,* 384 U.S. at 570.

Third, there must be some easily administered and substantively sound means of determining the terms (including price) on which the duty to deal will be enforced. *See Trinko*, 540 U.S. at 409-10 (distinguishing *Aspen Skiing* on this ground). Without this limitation, an antitrust duty to deal would impose on courts a regulatory duty for which they are unsuited and, as a result, lead to many inefficient and welfare-reducing mistakes.

Fourth, the refusal to deal must make no business sense for the defendant apart from its tendency to exclude rivals and thereby to create or maintain market power. It is critical, of course, that this condition not become an invitation for unhappy rivals to seek through antitrust

10 These conditions are not sufficient to justify antitrust intervention or even costly antitrust litigation. For example, in some cases, the costs of compliance with a duty to deal might so dwarf any pro-competitive benefits as to make a Section 2 remedy inappropriate.

litigation an occasion for open-ended second-guessing of the defendant's conduct. The Supreme Court cases finding a duty to deal involved defendants that were voluntarily dealing with others on the terms refused to the plaintiffs. Without a threshold showing of such dealing, the risks of error and the costs of litigation from the prospect of an antitrust-imposed duty to deal would likely far exceed its potential benefits.

Aspen Skiing, 472 U.S. 585, illustrates both the "no business sense" condition and the role of this threshold showing. In that case, the defendant Skiing Co., which owned three of the four mountains in the Aspen area, took "actions that made it extremely difficult for" the fourth mountain, Highlands, to compete effectively, *id.* at 594, and that "deterred [skiers] from skiing at Highlands." *Id.* at 610. Among other things, the defendant, without a plausible rationale, discontinued a popular and profitable "All-Aspen," 4-mountain, 6-day ski pass it had previously offered jointly with the plaintiff (Highlands) and refused to accept coupons issued by the plaintiff for ski tickets at the defendant's mountains, even though the plaintiff was willing to pay *the full retail price* for those tickets. *Id.* at 593-94. The effect of these actions was to force skiers who wanted to ski on the plaintiff's mountain to forgo the convenience and cost savings of a discounted multi-mountain, multi-day pass. In affirming a jury verdict against the defendant, the Court emphasized the profitability of the defendant's prior dealing with the plaintiff and its similar dealings with others and concluded that "the evidence supports an inference that [the defendant] was not motivated by efficiency concerns and that it was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival." 472 U.S. at 610-11.

As the Justice Department and the Federal Trade Commission explained in their amicus brief in the *Trinko* case, the Supreme Court and the courts of appeals have widely conditioned liability for refusals to deal on proof that the defendant, like the defendant in *Aspen Skiing,* "was not motivated by efficiency concerns" and was "willing to sacrifice short-run benefits and consumer goodwill" in order to exclude rivals and gain market power.[11] While the Court in both *Aspen Skiing* and *Trinko* used the language of "motivation," the analysis in both entailed an objective inquiry into the economic considerations that the defendant faced, *not* a subjective inquiry into the defendant's actual state of mind.[12]

This condition for liability—that the conduct in question does not make business sense for the defendant except as a means of excluding rivals and gaining or preserving market power—has been embraced in numerous lower court cases, even outside the refusal-to-deal context.[13] Indeed, far from hindering effective enforcement of the antitrust laws, it has been the

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11 *See* Brief for the United States and the Federal Trade Commission as Amici Curiae Supporting Petitioners, *Verizon Communications v. Law Offices of Curtis V. Trinko*, No. 02-682 2002 U.S. Briefs 682 (May 2003) at 16 (citing cases). Some commentators have disputed the economic and factual basis for the Supreme Court's finding that the defendant's conduct in *Aspen Skiing* made no business sense. *See, e.g.,* Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal – Why Aspen and Kodak Are Misguided,* 68 Antitrust L.J. 659 (2001). We do not address that factual issue here.

12 Although the Supreme Court used different language in its earlier decision in *Otter Trail Power Company v. United States,* 410 U.S. 366 (1973), its substantive analysis in that case was entirely consistent with this approach. The district court had found that the defendant's "refusals to sell at wholesale or to wheel were solely to prevent municipal power systems from eroding its monopolistic position" because "[t]here were no engineering factors that prevented [it] from selling power at wholesale to those towns that wanted municipal plants or wheeling the power," *id.* at 378, and the defendant had wheeled power to others. *Id.* at 378-80; *see also Trinko,* 540 U.S. at 410 (distinguishing *Otter Tail*); Joint Appendix at 103-111 in *Otter Tail* (district court discrimination findings).

13 *See, e.g., Stearns Airport Equip. Co. v. FMC Corp.,* 170 F.3d 518, 523-24 (5th Cir. 1999) (claim that competitor attempted improperly to influence municipality bidding process); *Advanced Health-Care Serv's. Inc. v. Radford Community Hosp.,* 910 F.2d 139, 148 (4th Cir. 1990) (exclusive dealing agreement); *General Indus. Corp. v. Hartz Mountain Corp.,* 810 F.2d 795, 803 (8th Cir. 1987) (revocation of credit to competing customer); *Neumann v. Reinforced Earth Co.*, 786 F.2d 424, 427 (D.C. Cir. 1986) (predatory litigation); *see also Trace X Chemical, Inc. v. Canadian Indus., Ltd.,* 738 F.2d 261, 266 (8th Cir. 1984) ("conduct without legitimate business purpose [is] conduct [that] makes sense only because it eliminates competition").

basis for all successful monopolization cases brought by the Justice Department in recent years, including *Microsoft*[14] and *Dentsply.*[15]

In the refusal-to-deal context, the Supreme Court's decisions, including *Aspen, Trinko* and *Otter Tail,* are all consistent with the no-business-sense analysis, including the requirement of a threshold showing of voluntary similar dealings with others on the terms denied the rival. The Seventh Circuit's decision finding, and the Justice Department's case alleging, that AT&T violated Section 2 of the Sherman Act by refusing to deal with rival MCI are also consistent with that analysis.[16]

The facts in *Trinko* were very different from the facts in these other cases in which violations of Section 2 were found. In *Trinko,* the defendant was alleged to have dragged its heels in complying with technically onerous regulatory obligations to make portions of its network available to rivals—obligations a network owner would never undertake absent regulatory compulsion because of the inherent costs and complications of shared management of a single network infrastructure. By contrast to cases like *Aspen Skiing* and *Otter Trail,* the defendant in *Trinko* was not voluntarily offering others similarly situated the services and terms

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14 *Microsoft*, 253 F.3d 34 (finding various kinds of anticompetitive conduct).

15 *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 190 (3d Cir. 2005) (holding that denture manufacturing monopolist violated Section 2 by requiring distributors, without any valid business justification, to agree not to purchase from rival manufacturers).

16 *See MCI Communications Corp. v. American Tel. & Tel. Co.*, 708 F.2d 1081 (7th Cir. 1983); Complaint, *American Tel. & Tel. Co., v. United States*, 1976 WL 1321, 1976-2 Trade Cas. (CCH) ¶ 61,097 (D.D.C. 1976) (No. 74-1698). The AT&T litigation concerned, among other things, AT&T's effort, by refusing to give rival MCI access to its monopoly local exchange networks, to protect its monopoly in long distance. Because providing access to MCI on remunerative terms would have enhanced the value of AT&T's local networks, AT&T's refusal, to sell to MCI access that it was selling to non-rivals, made no commercial sense except as a means of excluding MCI from the long-distance business. *Cf.* note 17, *infra* (noting AT&T's "cream-skimming" defense).

rivals demanded, so there was no basis to infer that the refusal to deal entailed forgoing a profitable course of conduct. Not surprisingly, therefore, as urged by the Justice Department and the Federal Trade Commission, the Supreme Court held that the refusal to deal made sense without regard to any prospect of increased market power (540 U.S. at 409) and was therefore not the stuff of an antitrust violation.

This distinction—between (i) conduct (like that in the *AT&T* case, *Microsoft, Dentsply,* and others) that makes no business sense but for exclusion of rivals and resulting market power and (ii) conduct like that at issue in *Trinko,* which makes good sense regardless of its effects on rivals—furthers important antitrust policies. Indeed, an antitrust rule that would find a violation in a monopolist's *failure* to sacrifice profits in order to help its rivals gain market share would be irreconcilable with the basic premises of antitrust law: that vigorous competition, rather than the pulled punch, is most likely to serve consumer welfare; that even monopolists are entitled to the proceeds of their "skill, foresight and industry," *Alcoa*, 148 F.2d at 430; and that the "charging of monopoly prices" is "an important element of the free-market system" because of the investment incentives that only the prospect of such prices can provide, *Trinko*, 540 U.S. at 407.

The "no business sense" condition, when applied together with the threshold showing discussed above, also provides meaningful guidance to firms so that they will know how to avoid antitrust liability without steering clear of pro-competitive conduct. Firms need ask only whether their conduct makes good business sense regardless of whether it increases their market power. This condition helps avoid the chilling effect on robust competition that an uncertain prospect of antitrust intervention can cause.

III. The Essential Facilities Doctrine

The policy considerations are no different in so-called "essential facilities" cases. The contemporary understanding of the essential facilities doctrine—at least insofar as it concerns, as here, single firm conduct—appears to derive from the Seventh Circuit's opinion in *MCI*, 708 F.2d 1081. As noted above, that case involved the refusal of AT&T to give MCI, a nascent competitor in long distance telephone service, access to its local exchange network, in which AT&T was a regulated monopoly. AT&T was providing such access to non-rivals. Because interconnection with MCI would have enhanced the value of AT&T's local exchange business, the court concluded that AT&T's refusal to deal made no sense except as a scheme to exclude MCI from the long distance business.[17] And the court made clear that it understood that the refusal to deal was intended to "extend" AT&T's monopoly "from one market [regulated local exchange] to another [long distance]," in which AT&T could exercise market power that (because of price regulation) was unavailable to it in the local exchange market. *MCI*, 708 F.2d at 1132.

It was in this context that the court articulated the circumstances under which an antitrust plaintiff might overcome the normal presumption that a firm can choose those with whom it will deal, *e.g.*, *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919). The court set forth a four-part test:

> The case law sets forth four elements necessary to establish liability under the essential facilities doctrine: (1) control of the essential facility by a monopolist;

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[17] We do not here address the merits of AT&T's antitrust defense that its conduct, designed to preclude cream-skimming of high-margin customers, was a necessary corollary to a regulatory scheme of implicit cross-subsidies needed for universal service. *See AT&T Decree Decision*, 552 F. Supp. at 161. Nor do we address when antitrust courts should exercise restraint in addressing conduct subject to the jurisdiction of a regulatory agency. *See generally Trinko*, 540 U.S. at 406 (discussing doctrine of implied antitrust immunity).

> (2) a competitor's inability practically or reasonably to duplicate the essential facility; (3) the denial of use of the facility to a competitor; and (4) the feasibility of providing the facility.

MCI, 708 F.2d at 1132-33. Some subsequent courts, however, have cited this language out of context as though the satisfaction of these four factors were a sufficient, and not just a necessary, condition for establishing antitrust liability for refusals to deal. In its initial opinion in *Covad Communications Co. v. BellSouth Corp.,* 299 F.3d 1272 (11th Cir. 2002), *vacated and remanded,* 124 S. Ct. 1143, for example, the court of appeals cited *MCI* for the unqualified proposition that "[t]he withholding of access to an essential facility without which a competitor cannot enter or compete in a market is a violation of the antitrust law." 299 F.3d at 1285. But these four factors cannot sensibly be deemed sufficient for that purpose, for they exclude other critical considerations such as the long-term costs, discussed above, of any broadly enforced duty to deal. While other courts have rejected essential facilities claims on the ground that the refusal to deal served legitimate purposes, they provide little guidance as to what a legitimate purpose might be.[18]

The Supreme Court has never endorsed the essential facilities doctrine; the *MCI* case might be the only one in which liability was ultimately based on it; and the doctrine has been

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18 *Compare City of Anaheim v. Southern California Edison Co.,* 955 F.2d 1373, 1381 (9th Cir. 1992) (rejecting essential facilities claim that would have interfered with the ability of the defendant to give the benefit of low cost power to its entire customer base rather than to just a few and thereby harmed the public), *with State of Illinois ex rel Burris v. Panhandle E. Pipeline Co.,* 935 F.2d 1469, 1483 n.13 (7th Cir. 1991) (finding it sufficient "that defendant sought to protect itself from added costs or lost profits" and concluding that defendant had legitimate business justification for denying access to its facilities where doing so would have caused it to incur significant liability under take-or-pay contracts), *cert denied,* 502 U.S. 1094 (1992); *Laurel Sand & Gravel, Inc. v. CSX Transp. Inc.,* 924 F.2d 539, 545 (4th Cir. 1991) (no essential facilities violation because it was not "feasible" for defendant railroad to grant trackage rights to plaintiff where doing so would have required "altering" defendant's relationship to "feeder" lines upon which it relied for "profitable traffic").

widely criticized.[19] Accordingly, as the *Trinko* Court suggested, the essential facilities doctrine should be either discarded altogether or treated simply as a subset of refusal-to-deal cases subject to all the requirements otherwise applicable to those cases. *See Trinko,* 540 U.S. at 411.

IV. Application of the "No Business Sense" Condition to Refusals to Deal

The "no business sense" element of liability for refusals to deal—the restriction of liability to cases in which the defendant's conduct would be irrational but for the prospect that the conduct will exclude competition—requires particular care in application because it is susceptible to a basic misunderstanding. Virtually any competitive strategy is designed directly or indirectly to win customers and sell products and, in that sense, to exclude competitors.[20] But if the conduct makes business sense *apart from* any tendency to enlarge the scope of the firm's market power—by, for example, lowering costs, improving product quality, or profitably expanding sales—it tends to promote the efficiency objectives that the antitrust laws should and do encourage.[21] Placing that kind of conduct beyond the reach of Section 2 leaves ample room

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19 *See, e.g.*, Philip E. Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 Antitrust L.J. 841 (1989).

20 As Judge Easterbrook put it, "[v]igorous competition 'excludes' rivals." Frank H. Easterbrook, *On Identifying Exclusionary Conduct,* 61 Notre Dame L. Rev. 972, 973 (1986); *see also* William J. Baumol & Alan S. Blinder, *Economics: Principles and Policy* 425-26 (8^{th} ed. 2000) (paragraph break omitted) ("[V]igorous competition may look very similar to acts that undermine competition and support monopoly power. The resulting danger is that the courts will prohibit, or the antitrust authorities will prosecute, acts that appear to be anticompetitive but that really are the opposite. The difficulty is that effective competition by a firm is always tough on its rivals.").

21 Businesses, of course, are not always in the habit of identifying or quantifying the precise short-term benefits of their conduct, and they may find it difficult to do so even after the fact in litigation. Even outside the refusal-to-deal context, therefore, courts should ask, with some deference, whether the defendant's conduct was reasonably calculated to achieve valid business objectives.

for that provision to prohibit conduct that is inefficient and does not constitute competition on the merits, as cases like *Microsoft, Dentsply, Aspen Skiing* and *AT&T* attest.

Difficulty in the application of the "no business sense" test can also arise when litigants or courts are imprecise in their definition of the market at issue. Sometimes, for example, the defendant's conduct involves two markets: an upstream market in which the defendant has lawfully gained a monopoly, and a complementary downstream market that is more susceptible to competition but in which the defendant supplies its upstream product as an important input. In such cases, a defendant cannot properly be held liable for seeking to preserve monopoly profits in the upstream market by refusing to share its advantage in that market with rivals—for example, by refusing to sell them the upstream product at lower than the profit-maximizing price.

Under some circumstances, however, a vertically integrated monopolist may refuse to deal in the upstream market for reasons that cannot be explained as an effort to realize monopoly profits in that market and can be explained only as an effort to extend that monopoly to the downstream market. Ordinarily, of course, a firm has no incentive to "leverage" its upstream monopoly to exclude competition in a complementary market. Under the familiar one-monopoly-profit principle, the firm will generally maximize its profits by encouraging greater demand for its upstream product through efficient competition in the complementary downstream market. But in some circumstances, a firm can earn greater profits by extending its monopoly into the downstream market.[22]

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22 These circumstances are summarized in Joseph Farrell and Philip J. Weiser, *Modularity, Vertical Integration, and Open Access Policies: Towards a Convergence of Antitrust and Regulation in the Internet Age*, 17 Harv. J.L. Tech. 85, 105-19 (2003).

Even in these circumstances, however, a refusal to deal is not necessarily anticompetitive. Dealing with an outsider might be less efficient than reliance on one's own vertically integrated operations, either because of the outsider's particular attributes or because integration of the functions of both markets within a single firm is less costly or more effective.[23] In effect, the decision of a vertically integrated firm whether to deal with rivals is a standard "make or buy" decision. There is no sound basis in antitrust law or policy to prohibit a manufacturer from making an efficient choice of this type. Thus, for example, if costs would be reduced or product quality enhanced by a monopoly automobile manufacturer's decision to make its own transmissions instead of buying them from others, the antitrust laws should not require the manufacturer to deal with third-party firms instead, even if the refusal to deal means that the manufacturer will have a monopoly in transmissions. Indeed, such make or buy decisions are ubiquitous, and interfering with them would harm both static and dynamic efficiency, thereby undermining the basic objectives of the antitrust laws.

Generalist antitrust courts are ill-equipped to determine in the abstract whether a given firm has a valid efficiency justification for vertically integrating rather than out-sourcing. To minimize uncertainty in imposition of a duty to deal, and to guard against false positives, courts should find a duty to deal only where the defendant's own course of dealing, as discussed, provides a reliable benchmark for determining that its refusal to deal is inefficient. Such a benchmark was available in *Aspen Skiing*, but was absent in *Trinko*—a distinction to which the *Trinko* Court attached appropriate weight. *Trinko*, 540 U.S. at 409.

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23 *See generally* Carlton, *supra* at n.9; Oliver Williamson, *The Mechanisms of Governance*, Oxford U. Press, New York (1996); Ronald H. Coase, *The Nature of the Firm* (1937), *available at* http://people.bu.edu/vaguirre/courses/bu332/nature_firm.pdf.

V. THERE IS NO NEED FOR NEW LEGISLATION

In large measure, U.S. antitrust law has prospered because it has developed mostly through a common law process, informed by an ongoing dialogue among courts, enforcement agencies, scholars, the business community, and the bar. While the antitrust restrictions on exclusionary conduct are rooted in the provisions of the Sherman Act, the statutory language is deliberately imprecise and has taken its meaning largely from the cases applying it. Antitrust doctrine has, accordingly, evolved over time, taking account of new learning about economics and business practices. Unsound decisions have generally been overruled[24] or ignored[25] and supplanted by new rulings better suited to contemporary competition issues.

Legislative intervention in this process would be unwise. Even if legislation codified what all might think today to be a sound antitrust principle, it would run the risk of soon becoming unsound in light of new economic insights and obsolete in light of market developments. This risk is especially great when, as now, rapid technological and marketplace changes proliferate throughout the economy. Legislated doctrine, because it is harder to change than judicial doctrine, would quickly become ossified, would interfere with efficient marketplace conduct or effective antitrust intervention or both, and would thus undermine the core antitrust objectives of robust competition and efficiency. The likelihood of such costs would be even greater to the extent that there is any uncertainty about the soundness of any codified principle.

There is no good reason to run such risks as a general matter, and there is certainly no good reason to run such risks with respect to refusals to deal. In addressing such refusals in

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24 *See, e.g., Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), *overruling United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *State Oil Co. v. Khan,* 522 U.S. 3 (1997), *overruling Albrecht v. Herald Co.*, 390 U.S. 145 (1968).

25 *See, e.g., United States v. Topco Assocs., Inc.*, 405 U.S. 596 (1972); *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966).

Trinko, the Supreme Court adopted a prudent, middle-ground analysis from which no Justice departed on the merits. That analysis is consistent with a principle on which the courts and the Justice Department have repeatedly relied and that has proven adequate both to prohibit anticompetitive conduct by monopolists and to prevent excessive intervention in the marketplace. There is no need for new legislation in this area.