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Ms. Deborah A. Garza
Chair, Antitrust Modernization Commission
Attn: Public Comments
1001 Pennsylvania Avenue, NW
Suite 800-South
Washington, DC 20004-2505

Re: Comments Regarding Exclusionary Conduct

Dear Ms. Garza:

On behalf of the International Bar Association, Antitrust and Trade Law Section, we are pleased to submit the comments of one of our four Working Groups, these comments being related to single firm exclusionary conduct and addressing refusals to deal, essential facilities, refusals to deal, bundling and related matters.

We hope that our views will provide a positive contribution to the Commission's work and we will certainly be pleased to answer any questions members might have.

Yours Sincerely,

Michael Reynolds
Chair of the Legal Practice Division of the International Bar Association

Cc:
Bruno Ciuffetelli, Chair, Antitrust Committee
John DeQ. Briggs, Co-chair, Working Group
Riccardo Celli, Co-chair, Working Group
Willam J. Kolasky, Co-chair, Working Group
Thomas McQuail, Co-chair, Working Group

INTERNATIONAL BAR ASSOCIATION

ANTITRUST COMMITTEE

WORKING GROUP ON US ANTITRUST MODERNIZATION

EXCLUSIONARY CONDUCT

I. INTRODUCTION

The IBA's Working Group on Exclusionary Conduct

1. This submission is made to the Antitrust Modernization Commission ("AMC") on behalf of a Working Group on Exclusionary Conduct established by the International Bar Association's Antitrust Committee with the specific task of providing comments to the AMC on specific issues of antitrust law and policy. The Members of the Working Group, are set forth in Annex A.

2. The Antitrust Committee of the International Bar Association ("IBA") brings together antitrust practitioners and experts among the IBA's 20,000 individual members from across the world, with a unique blend of jurisdictional backgrounds and professional experience. We are grateful for this opportunity to participate in the work of the AMC and we hope to contribute constructively to the process.

3. The Antitrust Committee has established Working Groups to examine and provide input to the AMC on four of the topics on which comment was invited where it appeared that international perspectives would be particularly relevant. This paper provides comments

on exclusionary conduct and the four questions on various forms of potentially exclusionary conduct there presented, those being:[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*[2], state an appropriate legal standard in this respect?

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

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

- 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?

II. GENERAL PRINCIPLES AND CONTEXT

4. Initially, of course, there is the question of market power or monopoly power (which in Europe is similar to, although not the same as, dominance).

5. Exclusionary conduct by dominant firms or putative monopolists, however hard at times to define, has been found in diverse markets and in various countries in relatively recent years.

6. In the United States, the Third Circuit found dominance in *LePages*[3] and *Dentsply*[4]; the Seventh Circuit found it in *MCI Communications v. AT&T*[5]; the D.C. Circuit found it in

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[1] 70 Fed. Reg. 28902-28907 (May 19, 2005)

[2] 540 U.S.398 (2004).

[3] *Lepage's Inc. v. 3M*, 324 F.3d 141 (3rd Cir. 2003).

[4] *U.S. v. Dentsply Int'l, Inc.*, 399 F.3d 181 (3rd Cir. 2005).

Microsoft[6]; the Sixth Circuit found it in *Conwood Tobacco*[7]; and the Supreme Court found it in *Aspen*[8] and *Kodak*[9]. In each case, the actor was found to be in some sense "dominant" or nearly so based on its market position in a relevant product market in the United States. The conduct found unlawfully exclusionary varied from aggressive business conduct at the point of sale of the product (*Conwood*); refusal to deal (*Aspen, MCI, Kodak*); exclusive dealing (*Dentsply, Microsoft*); software licensing restrictions (*Microsoft*) and bundling (*LePages*).

7. In Europe, exclusionary conduct is found in familiar conduct, but also in conduct less familiar to US agencies and counsel. Among the practices found to amount to exclusionary conduct when practiced by a dominant firm are: Loyalty discounts (*Virgin*[10], *Michelin*[11], *Hoffman-LaRoche*[12]; exclusive dealing (*Hoffman-LaRoche);* refusals to deal (*Bronner*[13], *IMS Health*[14]); and bundling (*Microsoft*[15]; *see also GE/Honeywell*[16]).

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[5] *MCI Communications Corp. and MCI Telecommunications Corp. v. American Telephone and Telegraph Co.*, 1982-83 Trade Cases 65, 137 (U.S.C.A. 7th Circuit).

[6] *Massachusetts v. Microsoft Corp.*, 362 U.S. App. D.C. 152 (2004).

[7] *Conwood Co., L.P. v. U.S. Tobacco Co.*, 290 F.3d 768 (2002).

[8] *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 427 U.S. 585 (1985).

[9] *Eastman Kodak Co., v. Image Technical Services, Inc.*, 504 U.S. 451 (1992).

[10] *Virgin/British Airways,* Commission Decision 2000/74/EC of 14 July 1999 *(OJ 2000 L30/1)*.

[11] Case T-203/01, *Michelin v Commission*, judgment 30 September 2003.

[12] Case 85/76, *Hoffman-La Roche & Co v Commission* [1979] ECR 461.

[13] *Oscar Bronner v. Mediaprint*, C-7/97, 1998, ECR I-7791.

[14] *IMS Health GmbH & Co. OHG v NDC Health GmbH & Co. KG*, Case C – 418/01.

[15] Case Comp/C-3/37.792 Microsoft, 24 March 2004.

[16] Case COMP/M.2220, General Electric/Honeywell v. Commission (2001). GE/Honeywell, of course, was not a case involving single firm conduct, but rather a merger case where the addition of products to a portfolio brought about a "range" or "portfolio" effect" effect and the prospect of anticompetitive bundling was one of the reasons for the merger being blocked. The is on appeal to the CFI and a decision is expected on this momentarily.

8. US law, influenced as it is by the private action, in turn driven in material ways by the lure of treble damages and attorneys fees, is more dependant for its vitality on the ability of the judiciary to adapt US competition law to the new economy as well as the old, and to the practices of today as well as those of tomorrow. The government, by which we mean the Federal Trade Commission ("FTC") and the Department of Justice ("DOJ"), has less control. However, government here has used many tools to influence this rae of the law, including: guidelines covering various issues of law and policy, some of which are specific to particular segments of the economy; speeches to the bar, the bench, and the business community; the filing of briefs with courts as *amicus curiae*; as well, of course, as bringing cases to establish important legal principles (*e.g., Microsoft and Dentsply*, among others).

9. There seems to have developed a broad consensus in the courts to the following effect, although not all decisions embrace the points below or are decided in accordance with these principles:
   - Competition law should protect competition, not competitors;
   - Whether a firm enjoys market power, or monopoly power, or is dominant is an important threshold issue because firms that do not enjoy this rarely if ever can threaten to injure, or actually injure, competition;
   - In general, single firm conduct that does not reduce output and hence raise price (or otherwise raise price) ought not be objectionable except in very limited circumstances;
   - Dominant firms that engage in conduct that injures or excludes a rival, and otherwise appears to have no "legitimate business purpose" (not having a "legitimate business purpose" in an antitrust sense is to engage in conduct that might benefit shareholders, management and the enterprise where that conduct is not directed to advancing efficiency, innovation, costs, quality and the like) are at risk of being held to have violated the law. This does not mean, of course, that

dominant firms may not lawfully exercise their market power by, for example, charging a monopoly price, which is a form of "legitimate business conducts" inasmuch as it is not exclusionary.

III. SINGLE FIRM CONDUCT

Essential Facilities and Refusals to Deal

10. The policy decisions for the AMC, and indeed for the courts and agencies, are substantially similar whether one speaks of "refusals to deal" or of the "essential facilities" "doctrine". In this paper, we discuss first the "doctrine" of essential facilities, and then address separately and briefly the matter of *Trinko* and the question of whether and how standards for exclusionary conduct might be modified.

11. Broadly speaking, the essential facilities doctrine compels a dominant firm that controls an essential facility to grant competitors reasonable access to the facility when that facility cannot be practically or reasonably duplicated by a competitor. The essential facilities doctrine has been applied in a number of international jurisdictions to ensure that competitors have access to a wide variety of necessary products or services, particularly in network sectors of the economy, including railway infrastructure and telecommunication facilities. For example, it has been applied in the transportation sector by the European Commission to cause a dominant air carrier to interline at competitive prorates on domestic routes[17]. In some of these cases, harm to competition arose

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17 Commission Decision of 26 February 1992 relating to a procedure pursuant to Articles 85 and 86 of the EEC Treaty (IV / 33.544, British Midland v. Aer Lingus), *OJ L96/34 of 10/04/1992,* examined whether the refusal by Aer Lingus to enter into an interline agreement with British Midland in respect of flights between London and Dublin amounted to an abuse of dominance. Aer Lingus held approximately 75% of the market for the London (Heathrow) - Dublin route, with British Midland providing the remaining share of the market. The Commission held that Aer Lingus was in a dominant position in respect of the London-Dublin air travel market and concluded that Aer Lingus was required to enter into competitive interline agreements with British Midland.

because competitors were denied access to the essential facility outright. In other cases, competitors were given access to the essential facility, but only on discriminatory terms or access was once provided and later denied. The theory behind the doctrine is that in certain circumstances denial of access to an essential facility can prevent entry into a market, with potentially significant anti-competitive effects.

12. Some variant of the essential facilities doctrine has been expressly codified in the competition legislation of various jurisdictions. For example, in 1995, Australia's competition legislation was amended to provide a right of access to essential facilities that is potentially applicable to all industries.[18] The South African *Competition Act* states that "[i]t is prohibited for a dominant firm to: … refuse to give a competitor access to an essential facility when it is economically feasible to do so".[19] A similar provision was adopted in the German *Act Against Restraints of Competition*, as part of the German competition law reform process in the late 1990's.[20] In Canada, competition authorities have suggested that a denial of essential facilities by a competitor in a dominant position could constitute abuse of dominance under the Canadian *Competition Act*.[21] In addition

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[18] A new Part IIIA, entitled "Access to Services", was inserted into the *Trade Practices Act, 1974*, pursuant to the *Competition Policy Reform Act 1995, No. 88, 1995.*

[19] South African Competition Act § 8(b) (1988), *available at* http://www.compcom.co.za/thelaw/thelaw_act_competition_acts.asp?level=1&child=1.

[20] Subsection 19(4)(iv) defines the following conduct as an anti-competitive act: An abuse exists in particular if a dominant undertaking … refuses to allow another undertaking access to its own networks or other infrastructure facilities, against adequate remuneration, provided that without such concurrent use the other undertaking is unable for legal or factual reasons to operate as a competitor of the dominant undertaking on the upstream or downstream market, this shall not apply if the dominant undertaking demonstrates that for operational or other reasons such concurrent use is impossible or cannot reasonably be expected.

[21] In Canada, the existence of the doctrine is not without doubt. Denial of access to essential facilities is not specifically enumerated in the list of abusive conduct found in the Act. There appears to be a lack of confidence among members of the Competition Bureau as to whether the Canadian *Competition Act* provides a remedy for denial of access to an essential facility (*see* Gilles Ménard, former Deputy Director, "Abuse of Dominance: Some Reflections on Recent Cases and Emerging Issues" Conference of the Canadian Institute on Competition Law and Business Practices (May 10, 1996), http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=949&lg=e). The airline specific provisions, introduced into the Canadian *Competition Act* following the merger of Air Canada and Canadian Airlines, include an essential facilities provision, applicable only to the domestic airline sector of the economy. Bill C-19 currently before Parliament proposes to remove the airline specific provisions from the Act. There was some

to express legislative provisions, an essential facilities doctrine of general application is recognized by courts of the United Kingdom and in the European Union.[22]

13. Perhaps the most often quoted modern articulation of the essential facilities doctrine in the United States was by the Seventh Circuit in *MCI Communications Corp. et al. v. AT&T*[23] which held that the four elements required to invoke the doctrine are:

- control of an essential facility by a monopolist;
- a competitor's inability or impracticability of duplicating the facility;
- feasibility of providing access to the facility; and
- refusal to supply access to the facility.

14. Whether these four elements are the elements of the offense, as it were, or whether they are four elements that are necessary, but not alone sufficient, to bring into play the doctrine is not of great moment. In either case, the doctrine or notion is self -limiting in that it only applies to those exceptional circumstances, where the essential facility can not be reasonably duplicated by the competitor, and where it is feasible for the facility to be shared. In light of the more precise nature of the doctrine, compared to the more general principles governing refusals to deal, it is not at all clear that there exists a problem crying out for a solution, despite the fact that highly skilled minds have called for greater definition of the doctrine[24]. In the United States at least, it seems to have been called into play only once in the last fifty years.

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discussion before the Parliamentary committee considering the Bill as to whether an essential facility provision of general application should be employed following the removal of the airline specific provisions, but it appears that the general abuse of dominance framework will be used instead.

[22] *See Sealink/B and I – Holyhhead: Interim Measures*, [1992] 5 CMLR 255; *Commercial Solvents v. Commission*, [1974] ECR 223, [1974] 1 CMLR 309.

[23] *See United States v. Terminal Railroad Association of St. Louis*, 224 U.S. 383; *MCI Communications Corp. and MCI Telecommunications Corp. v. American Telephone and Telegraph Co.*, 1982-83 Trade Cases 65, 137 (U.S.C.A. 7th).

[24] *See e.g.,* P. Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 Antirust L.J. 841 (1989).

15. The U. S. Supreme Court in *Trinko* stated:

> This conclusion would be unchanged even if we considered to be established law the "essential facilities" doctrine crafted by some lower courts, under which the Court of Appeals concluded respondent's allegation might state a claim. See generally Areeda, Essential Facilities: An Epithet in Need of Limiting Principles, 58 Antitrust L.J. 841 (1989). We have never recognized such a doctrine, *see Aspen Skiing Co. 472 U.S., at 611, n. 44; AT&T Corp. v. Iowa Utilities Board, 525 U.S. at 428* (opinion of Breyer, J.), and we find no need either to recognize it or repudiate it here. It suffices for present purposes to note that the indispensable requirement for invoking the doctrine is the unavailability of access to the "essential facilities"; where access exists, the doctrine serves no purpose[25] [emphasis added].

While some have suggested that the decision in *Trinko* casts doubt on the continued viability of the essential facilities doctrine, it is clear that the Court did not repudiate or accept the doctrine, but rather found it inapplicable in circumstances where the regulatory scheme provided access to the facility. However, even if the court clearly avoided making a decision about whether the doctrine exists in U.S. antitrust law, the citation of both the Areeda article and Justice Breyer's opinion in *AT&T*, both critical of the doctrine, does at the very least cloud the issue.

16. In light of the uncertainty surrounding the essential facilities doctrine, the question posed by the AMC must be answered not only as to whether an "essential facilities" doctrine should exist as an "independent" basis of liability under Section 2 of the *Sherman Act*, but more substantively whether or not an essential facilities doctrine should exist in U.S. antitrust law at all. We believe that a narrowly defined essential facilities doctrine, while almost certainly rarely called into play, nonetheless can support dynamic competition. It weighs against the exclusionary potential of market power and supports entry and efficiency in the marketplace. It can also be important, although it has not directly been

[25] 540 U.S. 398, 415 (2004).

so held in the United States, in addressing anti-competitive effects that can occur in markets with network monopolists, including newly privatized monopolies. In *Trinko* the Court noted:

> One factor of particular importance is the existence of a regulatory structure designed to deter and remedy anti-competitive harm. Where such a structure exists, the additional benefits to competition provided by antitrust enforcement will tend to be small, and it will be less plausible that the antitrust laws contemplate such additional scrutiny. Where, by contrast, "[t]here is nothing built-in to the regulatory scheme which performs the antitrust function," *Silver v. New York Stock Exchange*, 373 U.S. 341, 358 (1963), the benefits of antitrust are worth its sometimes-considerable disadvantages[26].

17. This statement lends support for the view that the essential facilities doctrine can be particularly important in sectors of the economy where there is no regulatory scheme providing access to new entrants and exclusionary conduct may lead to anticompetitive effects. The utility of the doctrine has been particularly noteworthy in the European Union where the deregulation of network sectors of the economy was often accompanied by the existence of previously state-owned monopolies who became almost instantaneously dominant players in a privatized environment. Even in the United States, where state owned monopolies are rarely a concern, consolidation and deregulation in network sectors of the economy and the emergence of network monopolists may alsos provide a role for the essential facilities doctrine.

18. The recognition of the essential facilities doctrine in U.S. antitrust law also finds some support for its value in promoting convergence or harmonization of antitrust legislation. It has been noted that: "a lack of convergence constitutes a trade barrier", "convergence reduces compliance costs for companies conducting international business" and "convergence ends the need for states to apply their competition laws extraterritorially, and the corresponding need of target states to enact blocking or claw-back statutes."[27]

[26] *Id.*

[27] Daniel Steiner, *"The International Convergence of Competition Laws"* 24 Man. L.J. 577 at 581 (1997).

These advantages have prompted a number of largely unsuccessful attempts at harmonization of international competition laws, including: the United Nations Conference on Trade and Development's *Restrictive Business Practices Code*[28], the Organization for Economic Cooperation and Development's *Interim Report on Convergence of Competition Policies*[29] and the *Draft International Antitrust Code*. The broad international recognition of the essential facilities doctrine and the policy objectives it serves, together with the benefits of international harmonisation, provides added support for continuing recognition of the essential facilities doctrine in U.S. antitrust law in those limited circumstances where it could ever actually apply.

19. Refusals to deal are in some sense first cousin to essential facilities, and also called into play only rarely. The U.S. Supreme Court's decision in *Trinko* has nicely kept alive the cause of action while greatly limiting its applicability. Comments submitted to the AMC by the US Telecom Association make the core point that "… 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 consequence 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." We concur with the thought that inasmuch as imposition of any duty to deal always threatens inefficiencies, any such duty should be carefully limited. Certainly, absent market power, a defendant should have no such duty. Other prerequisites include these: the existence of market power by the actor; conduct by the actor that is not directed to innovation, efficiency, product or service improvement; conduct that, upon investigation, is found to be a more or less naked attempt to exclude competition to the detriment of the long term interest of consumers (or what is sometimes

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[28] U.N. Doc. TD/RBP/CONF/10 (1980), reprinted in 19 I.L.M. 813 (1980).

[29] OECD/GD (94) 64, Paris, June 1994 (on file with OECD).

spoken of as conduct without a "legitimate" business purpose); and conduct that results in the maintenance of a monopoly by the actor (or that threatens to create a monopoly) in some appropriately defined relevant market.

20. We intend to strike here a middle ground between interventionists and minimalists. The US courts have exhibited an admirable fluidity in applying the law and addressing the received wisdom of the time period in which it operates. *Trinko* is in this mold, and sets forth a most welcome and workable standard that is at once clear, yet also somewhat flexible. *Trinko* does not provide rules or balancing tests or lists of factors, but it does provide at its core a test that seems quite capable of sifting out the bad cases from the good. *Trinko* teaches firms that they can generally rest easy about their conduct even if they enjoy market power -- except where that power is exercised in a way that makes sense for the company only by virtue of its likely effect of excluding rivals and thereby adding to or maintaining the actor's market power. For courts steeped in the traditions of the common law, this is a very good rule indeed, and not one that seems in our view to be in need of codification or further elaboration.

IV. BUNDLING

21. The challenging competition policy issues related to "product bundling" or "bundled rebates" by "dominant" firms has been underscored in recent years, ironically, by the seeming partial "convergence" of US and EU law in the area: before *LePages*, US law had not concerned itself with above cost pricing of bundled products, although in Europe, such conduct has occasionally resulted in governmental intervention both in a conduct setting (*e.g., Guiness*/*Grand Metropolitan*), and also in a merger setting (*e.g., GE/Honeywell*). The U.S. Supreme Court declined to hear *LePages*, perhaps heeding the

advice of the Department of Justice Antitrust Division, which argued that more experience was needed to discern the proper rules for bundling cases.[30]

22. While "more experience" is always desirable, bundling is not new and we suggest that, in general, competition best flourishes when rules are reasonably clear, generally consistent, and grounded in principles that are pro-competitive. Therefore, we set forth below some principles that we believe the AMC should recommend in the area of assessing single firm conduct in the context of bundling. We do this from the perspective of the IBA's Antitrust Committee's goal of promoting competition policies that further the effective and efficient functioning of global competition for the benefit of the consumers of goods and services.

23. But *first*, what is "bundling?" Bundling can take several forms.[31] The typical complaint involves a firm "bundling" a popular or arguably "dominant" product with a

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[30] In 2002, the DOJ was quite clear in its criticism of the EU's views of "range effects" or "portfolio effects", which represent a form of bundling. EU law has recognized two theories under which liability can be imposed by virtue of "range" or portfolio" effects: (a) the holder of the portfolio can try to impose upon customers (retailers mainly) products they would not otherwise be willing to buy and (b) the competitive range of products can be used to take up more space on the retailer's shelves in order to limit the space available to rivals and hence exclude them from a market. The DOJ, in its contribution to an OECD Best Practice Roundtable was "…very concerned that the range effects theory of competitive injury that is gaining currency in certain jurisdictions places the interests of competitors ahead of those of consumers and will lead to blocking or deterring pro-competitive, efficiency-enhancing mergers." *See* Charles A. James, *International Antitrust in the 21st Century: Cooperation and Convergence,* Address before the OECD Global Form on Competition, Paris, France, October 17, 2001 at 4-5; William J. Kolasky, *Conglomerate Mergers and Range Effects: It's a Long Way from Chicago to Brussels,* Address before George Mason University Symposium, Washington, DC, November 9, 2001.

[31] It is important to realize the distinction between *bundling* and *tying*. Tying involves actual *non-economic forcing*, which prevents competition in the tied product so long as the tying product is essential. The tying firm capitalizes on its market power in the tying product, preying on the buyer's lack of effective options in order to injure competitors in the tied market. As a result, the buyer is often left with a deal it would have preferred not taking.

In contrast, bundling, or at least mixed bundling, involves providing *economic incentives* to purchase two or more products. A bundling firm does not prey on the buyer's lack of options; instead it provides an incentive to the buyer to take additional products by lowering the price of the bundle to somehting lower than the separate sum of each component. Competition in the market for the bundled product may or may not be affected, but typically the buyer (in the short term) is made *better off* by accepting the bundle. Thus, unlike tying, which is *per se* illegal in certain circumstances, bundling arguably involves fundamentally pro-competitive conduct – lowering prices.

complementary or other product(s) and offering economic incentives (*e.g*., a rebate across the "bundle") to buyers to purchase all the products within the "bundle." This is generally referred to a "mixed bundling" – the bundle is discounted to a price that is below the price that one would pay for both items outside the bundle. Notably, too, in this form of bundling all of the bundled items are separately available outside the bundle. This is thus distinct from "pure bundling", where the items in the bundle are available *only* in the bundle and not separately, a practice akin to tying.[32] This is also distinct from technological tying, where two products are technologically integrated together and not sold separately. *See e.g.,* the EC decision now on appeal in *Microsoft.*[33]

24. What interests should courts and regulators seek to foster when assessing the legality of bundling practices? We suggest rules that would focus on the competitiveness of relevant *markets,* even though such rules would not necessarily protect each *competitor* in a given market except where the threat to a rival was itself a threat to future competition. The crafting of such rules takes care, as bundling cases fit the paradigm memorably described a quarter century ago in Judge Borks's *The Antitrust Paradox* -- that is, bundling cases can give rise to court-crafted "solutions" to competitive "problems" that have the effect of *stifling* rather than *promotin*g competition and hence operating to deny consumers the benefit of lower prices and more choices.[34] We should be clear, too, that we are not focusing upon predatory bundling where the price charged is below some appropriate measure of cost. Those situations are well in hand under the principles laid out by the Supreme Court in *Brooke Group.* We are also not talking about the sort of technological

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[32] But it is different from tying as in a tying situation the firm offering the bundle is confronted by rivals who offer one or more of the bundled items separately. *See* Kobayashi, *Bunding: A Survey of the Economic Literature,* Unpublished Draft at 3 (May 9, 2005).

[33] Case Comp/C-3/37.792 Microsoft, 24 March 2004.

[34] *See*, Bork, *The Antitrust Paradox passim* (1978). This is so where to condemn bundling is to condemn agreements that are *too good* for consumers in the present because, sometime in the future, the pro-consumer benefits might dissipate (if they foreclose competition on the merits) and consumers might end up at the mercy of a "dominant" or "monopolist" firm. Given the uncertainty of the future harm, judicial rules should be carefully crafted to ensure that foregoing the present consumer benefit is worth the prospect of preserving long-term competition, the threat to which might be quite illusory.

bundling seen or alleged in the EC's *Microsoft* case – where the abusive conduct found by the Commission was the addition or integration (depending one's view of the facts) of products so as to obtain a head start in markets for other products.[35] We are focusing here, rather, on pure pricing issues involving mixed bundling.

25. We urge the AMC to make clear that increased market share from non-anticompetitive practices does not equate to any increase, or certainly any unlawful increase, in market power. While an inference of market power may be appropriate if a firm already has a high or "dominant" market share for the popular or "dominant" product, it is not appropriate to presume that every act that increases market share, such as lowering prices on the bundle to increase sales, involves the probable achievement and abuse of that firm's "market power" (even by a firm having a popular or arguably "dominant" product).

26. But while market share should not be dispositive, it does have a role to play in the antitrust and economic analysis of bundling. If the bundling firm or firms have a high percentage of the market locked up with "bundles," then there is a greater chance that rivals will be unable to operate at efficient scale and will be driven from the market or find it uneconomic to enter. Conversely, if the other competitor(s) have a high enough market share, and if rival operations are generally profitable, it is unlikely that market exit will occur or that competition will be injured. We believe, consistent with current case law, courts should feel confident that judicial involvement is unnecessary if the defendants' (collective) market share is less than some benchmark share -- perhaps as low as 35% or as high as 50%.[36]

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[35] The EU Commission's 2004 decision in the Microsoft case is currently undergoing *de novo* review by the European Court of First Instance where Microsoft asserts, *inter alia*, that there is no bundling because Windows is a single integrated product and the Windows Media Player functionality is a feature of the operating system rather than an independent product

[36] Of course, there is nothing magical about the either of these share numbers except that each has some judicial or regulatory "gloss". For example, as in exclusive dealing claims, if the market is highly concentrated and all the major competitors insist on exclusivity provisions, the 35% threshold for each defendant may be appropriate. *Minnesota Mining & Mfg. Co. v. Appleton Papers, Inc.*, 35 F. Supp. 2d 1138 (D. Minn. 1999) (30-

27. Any increase in one firm's market share, by definition, "excludes" competition as it necessarily reduces (or "forecloses") the share of other competitor(s). But, seeking increased share is the essence of competition. And, price decreases are almost always pro-competitive -- even if some higher cost competitors go out of business. Indeed, the *exit* – as well as the entry – of rivals is part and parcel of healthy, well functioning, competitive markets in the United States and worldwide.

28. To further the increasingly globalized -- and competitive -- marketplace, the AMC's recommended rules on single firm conduct should encourage courts and regulators to make a careful analysis of the balance between *current* pro-competitive benefits and potential *future* harm in assessing any concerns about single firm conduct, particularly in the context of bundled pricing. Of course, any such analysis must be mindful that too lenient a standard may give license to "dominant" or monopolistic firms to squash competitive rivals to the detriment of consumers, whereas overly stringent rules may chill pro-competitive conduct and become a refuge of protectionism.

29. Thus, as has been widely recognized and accepted in the context of merger analysis, we urge that inferences based on market share – while useful as a threshold matter – should not be dispositive, but only an indicator as to when more detailed inquiry should be made. A market share rule -- while serving the interests of clarity and predictability -- would ill-serve enhanced globalized competition by unnecessarily restricting legitimate competition by large market share firms. In so doing, it would give too much protection

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40% share must be foreclosed); cf. FTC and DOJ's *1992 Horizontal Merger Guidelines*, § 2.211 (noting the potential for "unilateral effects" if a firm's post-merger market share exceeds 35%). Even in this case, however, the 50% threshold may be adequate, given the fact the competition among the existing competitors should suffice to keep prices at competitive levels, assuming the "bundling" does drive any rival from the market. Indeed, courts seem in general to view 50-60% as a threshold beyond which there might be real issue about the existence of market power. *Compare Blue Cross & Blue Shield United of Wisconsin v. Marshfield Clinic*, 65 F.3d 1406, 1411 (7th Cir. 1995) ("50 percent is below any accepted benchmark for inferring monopoly power from market share.") *with Re/Max Int'l, Inc. v. Realty One, Inc.*, 173 F.3d 995, 1018-19 (6th Cir. 1999) (finding 51% market share sufficient)

to smaller, potentially less cost-efficient competitors with no clear benefit to consumers and competition.

30. Instead, we respectfully submit that any analysis of single firm conduct is best informed by a merger-inquiry-like examination of the real purpose of the "bundling" or other conduct and the market evidence from consumers, competitors, other market participants, economic experts and other experts, as to the probable effects on supply, prices, quality and innovation, both in the near and longer term.

31. Is the real purpose, and probable effect, a likely increase in sales, market supply, quality or innovation or is it a net reduction in output, quality and innovation over time, allowing the arguably dominant firm to exercise and abuse its existing or newly achieved market power? To answer that ultimate question, the AMC should recommend the following four-step analytical framework:

    - The terms of the "offending" conduct should be precisely identified.
    - Before condemning bundling conduct, the court (or regulator) should ensure that the bundling incentive makes no economic sense absent future foreclosure of meaningful competition.
    - There must be proof that competitors cannot rationally meet the prices being offered by the "dominant" firm.
    - The likelihood of recoupment should be examined so that the existence of a long-term competitive impact is understood.

32. **The Terms of the "Offending" Conduct Should be Precisely Identified.** A supermarket does not "bundle" milk and eggs just because a customer happens to put both in the same shopping cart. Likewise, a manufacturer does not -- necessarily -- "bundle" its products just because it negotiates the prices of all its products in a single sales meeting. Thus, it is important that the actual economic incentives used to encourage

"bundled" purchasing be understood. Only by realistically measuring the "bundling incentive" can it be determined whether:

- The incentive is "legitimate" (*i.e.* supply, quality, service and/or innovation enhancing),
- Competitors can effectively match the benefit, and
- The probable result will be to drive competitors effectively from the market for the reasonably foreseeable future.

33. To start the analysis, the bundling complainant (typically, a foreclosed competitor) should have the burden of identifying and proving the terms of both the "bundled arrangement" and the "but-for" unbundled arrangement. The "bundled arrangement" is the actual understanding between the seller and the customer. The "but for unbundled arrangement" consists of the prices, products, and volumes that *would have been* accepted by the buyer in the absence of the "bundling incentive."

34. For example, a customer that uses "a buy 2 get 1 free" coupon at a local grocery store may have purchased 0, 1, 2, or 3 of the products without the coupon. If the customer would have bought just 1, then the coupon induced the customer to purchase two additional products, which it could have foregone or purchased from a competitor.

35. Only by requiring the complainant to identify the terms of the actual arrangement and the "but-for" unbundled alternative will the court or regulator be able to measure -- let alone evaluate the legitimacy of -- the bundling incentive. Thus, in the volume discount context, a manufacturer may offer to sell 100 widgets for $1000 and 200 widgets for $1500. Or, in the bundled product context, a manufacturer may offer to sell 100 gadgets for $1000 or a bundle of 100 gadgets and 100 widgets for $1500. In each of these cases, the core question is whether a manufacturer has the right to sell the last 100 widgets for $50 each.

36. Determining what would have been the "but-for" unbundled arrangement will not always be easy. And the terms of *offers* that the customer *rejected* are not necessarily determinative of what the "but-for" unbundled arrangement would have been. But rather than dispense with this threshold requirement, we suggest this should be treated as an ordinary threshold factual question in which the complainant carries the burden of proof, while the actor would have an opportunity to rebut the claims concerning the prices and volumes the customer would have accepted had the law precluded the actual bundled arrangement.

37. For example, the complainant may assert, based on emails or other communications between sales people, that the manufacturer would have raised or "jacked up" the prices of the "bundling product" in order to coerce the customer to accept the package. But upon further analysis, it may be established that the threat was not credible, perhaps because the defendant did not really posses the power unilaterally to raise prices. In such a case, it would make no sense to hold the defendant liable if the prices and terms of the alleged (illegal) bundled arrangement *and* the (legal) unbundled arrangement (as opposed to non-credible "offer"), turn out to be essentially the same.

38. Once the fact finder has established the exact "economic incentives" used to induce the sale, it can proceed to the next analytical step: assessing whether there is a legitimate reason for offering the incentives, and whether competitors would be so unduly -- and effectively -- foreclosed from the market as to justify condemnation of the price concession.

39. **Does the Bundling Incentive Make Economic Sense Absent Future Foreclosure?** Since the "bundling incentive" often benefits customers, it is important to investigate whether there is an adequate business justification for making the offer. We suggest that, absent extraordinary circumstances, liability should not attach unless the cost of the *economic incentive* causes the defendant to lose money on the additional sales made

possible by the bundle. This requires an analysis of the "marginal" profit on additional sales made possible by the bundle and the cost of the bundling incentive.

40. If the bundling incentive causes customers to purchase more products and the seller makes a profit on those additional sales, it is difficult to see why the law should condemn the conduct. Indeed, we respectfully submit that *LePage's* was fundamentally flawed as a statement of the appropriate rules by failing to acknowledge that a motive to make profitable sales is itself pro-competitive, and should be a sufficiently legitimate business reason to justify a bundled offer. *LePage's* took a plainly restrictive view of what business justifications would suffice by requiring 3M to prove demonstrable "cost-savings". Thus, we do not believe a court or agency should impose liability for bundling conduct if the net revenue between the bundled and unbundled arrangements is positive, after taking into account the marginal cost of the additional product(s) being sold.

41. For example, if a company offers to sell two products, A and B, for $10, but product A alone for $7, then there should be no liability if the marginal cost of producing product B is *less* than $3. Similarly, if a company offers to sell 50 widgets for $100 (*i.e.,* $2/unit), and 60 widgets for $110, then there should rarely if ever be liability if the marginal cost of producing the last 10 widgets is *less* than $10 (*i.e.*, $1/unit).[37] This is the appropriate outcome inasmuch as, if the net revenue between the offers is positive, then the seller is pricing the bundled product (here, product B) above its own costs and generally speaking, above-cost pricing should be thought of as pro-competitive pricing that should not be actionable under federal antitrust law.

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[37] In making this allocation, care must be taken to properly allocate differences in the "bundling" product's price. In general, the price for the bundled product equals the price for the package minus the price for bundling product. So for example, if a company offers to sell product A for $6 if the customer also buys product B for $4, and also offers to sell product A alone for $7, then the true effective price for Product B is $3.

42. In making the calculation of whether the seller's prices are above cost, we believe the seller should bear the burden of proof. Not only does the seller have a better understanding of its costs, but in seeking to establish that the bundled offer makes "economic sense," it can take into account economies of scale and other cost-efficiencies (if any) that may justify the offer as making good economic sense.

43. **Can the Seller's Prices Rationally Be Matched?** In *LePage's*, the court rejected the need for any showing that the defendant's prices (however allocated) were below cost. We regard that as a mistake. But, regardless of whether courts and regulators require a showing that the prices are below cost, at a minimum, the court should require the complainant to show that it would be unable -- profitably -- to make an equally attractive offer. In addition, companies may choose not to pursue certain business opportunities, even if they would be profitable, because the business might not meet corporate "internal rates of return," "hurdle rates," or "margin" thresholds, or might fail to cover all fixed costs. Just because bidding for new business might cut close to the bone, however, does not mean that it is economically unprofitable. Indeed, some firms might rationally choose to maintain a "premium" image and decline to lower price for fear that doping so might "devalue the brand," or cause other customers to seek equally favorable pricing.

44. While such fears may make business sense, a competitor's complaint should not be found meritorious if the rival could have won the business and still made a profit, but chose not to pursue that opportunity. Thus, we suggest that a complainant should normally be required to prove that actually submitting a successful bid would have been *economically* irrational for some reason, for example because doing so would have required setting a price below the variable cost of supplying the products or services that could have been, but were not, sold.

45. It should not be sufficient to end the analysis with a conclusion that the complainant could not match the defendants' offer term-for-term across the entire bundle. Rather, the

proper question should be whether the complainant could submit a winning bid for *some* of the customer's requirements, (*i.e.*, the bundled products) recognizing that other products might be sourced from the defendant (or other suppliers). Thus, if the alleged "dominant" firm offers to sell product A for $7, and A and B for $10, then a complainant seeking to sell product B would have to prove that it could not profitably sell product B for $3.[38]

46. In short, if the dominant firm's prices are above cost, and the complaining competitor could have matched them but chose not to, the competitive effects inquiry should end. This result, with the notable exception of *LePage's*, is consistent with the longstanding rule that, so long as the dominant firm's pricing is non-predatory, an "equally efficient" competitor (a seller of a substitute for Product B) can compete for, and win, the business with a competitive offer. *See Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F.Supp. 455, 469 (S.D.N.Y. 1996) (noting requirement that bundling foreclose an "equally efficient" competitor).

47. A lesser standard could itself be anti-competitive as it could, and surely would, result in the treble damage, class action punishment of firms that sells at low, but non-predatory prices. The mere threat of such punishment is a real deterrent to lowering prices, something that is decidedly pro-competitive.. Moreover, any such approach converts courts and government officials into price regulators, something that does not, as history has repeatedly proven, well serve the consumers that competition policy is designed to benefit.

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[38] Indeed, because the complainant would have to show that it would not be profitable to match the allegedly "dominant" seller's prices, it would not be able to establish antitrust injury unless it can show that -- but for the bundle -- the seller would *not* have made an attractive unbundled offer, allowing the complainant *profitably* to undercut the "but-for" unbundled offer.

48. **What Is the Likelihood of Recoupment?** Where the complainant is unable to make an equally attractive offer for the bundled products, and where the alleged "dominant" seller fails to prove that the bundling incentive is economically profitable, the court or agency should proceed to the final step of determining whether the seller has and can use its market power to control and unilaterally raise the market price in the future. This final piece of evidence is necessary to avoid chilling pro-consumer, lowered prices. So long as there is no reasonable probability of future, unilaterally imposed, price increases as a consequence of the foreclosure, competition is not injured (though a competitor may be) and consumers are well served.

49. Thus, for a bundling strategy to make sense, a future market-wide restriction of capacity or output ought be proved, such that future price increases are likely. This burden should be borne by the foreclosed competitor. One way to demonstrate the requisite output reduction might be showing, in addition to barriers to entry, that a significant competitor would be effectively driven from the market, rendering it unlikely to compete in the future. Another way might be to demonstrate substantial foreclosure that raises rivals' costs by, for example, preventing smaller competitors from achieving necessary economies of scale.

50. Finally, there should be some showing that the future price increases would exceed (in expected value) the actual value of the bundling incentives, since otherwise customers benefit from the defendants' bundling strategy. In making this determination, various factors ought to be considered, including whether the contracts at issue are terminable at will, and whether other factors will allow competitors to enter or expand at sufficient scale.

51. Because courts and agencies have not consistently approached bundling claims with this level of rigor, it is unclear how often theoretically dominant sellers actually embark on bundling strategies that depend on future, long-term exclusionary effects, so that

recoupment is reasonably probable. But, as a matter of competition policy, there is a need to address in some appropriate way the potential for such anticompetitive "strategic behavior strategies".

52. The reality is that some firms do possess some amount of market power and have strong incentives for using bundling to prevent rivals from encroaching on their "territory". Thus, where the evidence is that the probable effect of the bundling is foreclosure and a reasonable likelihood of recoupment through higher prices in the foreseeable future, then antitrust and competition policy should step in to preserve and promote increased competition.

53. That is necessary because, if consumers -- for whom the complainant and the agencies are the proxy -- considered the effect of truly anticompetitive bundled pricing over the long term on consumers *as a class*, they would refuse the bundled prices, since in the post-predation period they will find themselves at the mercy of an even stronger dominant-share firm. But since individual consumers cannot be expected to pass on offers that are "too good to be true," or to consider the long term welfare of buyers as a class, it is appropriate for antitrust to step in and protect the class of buyers threatened by a pricing campaign that will eventually injure them. But where, instead, a complainant's claim boils down to a mere grumblings about losing out to a bigger fish, the court or regulator should quickly dismiss the complaint as anti-consumer, competitor protectionism, as is largely today the normal response in a merger setting.

V. HOW SHOULD THE STANDARDS BE SET?

54. As most of these comments have suggested, there seems to be little need for the codification of competition principles. The courts have done a commendable job in general, despite some cases that have seemed to protect producers at the expense of consumers. But, in the area of exclusionary conduct in general, there is certainly room

for more competition policy advocacy by the agencies. Such advocacy might can be presented in the form of amicus briefs in particular and perhaps in speechmaking directed at the judiciary, and in guidelines directed not just to the bar and the corporate community, but also to the bench. Sensible approaches are well known and generally well understood within the DOJ and the FTC. And while these agencies cannot ride herd on all of the cases in all of the courts, there could be a more aggressive amicus program in the US Circuit courts, which may assist the courts in those cases where the stakes for competition law are high. In short, we think the courts can in general be trusted to guard our competition laws, but they could use help from time to time so that they are clear about the stakes.

Annex A

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