UNITED STATES FEDERAL TRADE COMMISSION

and

UNITED STATES DEPARTMENT OF JUSTICE

SHERMAN ACT SECTION 2 JOINT HEARING

BUSINESS TESTIMONY

TUESDAY, FEBRUARY 13, 2007

HELD AT:

UNIVERSITY OF CHICAGO

GRADUATE SCHOOL OF BUSINESS

EXECUTIVE CENTER - 450

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CHICAGO, ILLINOIS 60611

9:30 A.M. TO 4:00 P.M.

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APPEARANCES:

MODERATORS:

Morning Session:
JAIME TARONJI, JR.
Attorney, Policy Studies,
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and
JOSEPH J. MATELIS, II
Attorney Advisor, Legal Policy Section
Antitrust Division, Department of Justice
and
WILLIAM COHEN
Deputy General Counsel for Policy Studies
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PANELISTS:

Morning Session:
David Balto
Patrick Sheller
Ron Stern

APPEARANCES CONTINUED:

MODERATORS:

Afternoon Session:
JOSEPH J. MATELIS, II
Attorney Advisor, Legal Policy Section
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PANELISTS:

Afternoon Session:
Sean Heather
Bruce Sewell
Bruce Wark

REPORT OF PROCEEDINGS

FEBRUARY 13, 2007

MR. TARONJI: Good morning. I'm Jim Taronji from the Federal Trade Commission. I'm one of the moderators for this morning's session. I'm joined this morning by Bill Cohen, Deputy General Counsel for Policy Studies at the Federal Trade Commission. Our other co-moderator today is Joe Matelis from the Antitrust Division of the U.S. Department of Justice.

Before we start today, let me cover a few housekeeping matters. As a courtesy to our speakers, please turn off your cell phones, Blackberries, and other devices, or put them on vibrate. And I will do that myself.

Finally, we request that the audience not ask any questions or make comments during the hearings. Thank you.

Before introducing our speakers, I would like to first thank the University of Chicago Graduate School of Business for hosting these joint FTC/DOJ hearings to solicit business testimony on single-firm conduct under Section 2 of the Sherman Act. In particular, I would like to thank Dean Ted Snyder and the staff of the Gleacher Center for offering us their facilities and for making the necessary arrangements for us to hold these hearings.

And finally, I would like to thank my FTC and DOJ colleagues as well as the FTC's Midwest regional office who have worked very hard to put together these hearings in the Windy City, in the cold Windy City.

We are honored to have assembled a distinguished group of panelists from a number of companies and associations that have agreed to offer their testimony in connection with these hearings. These panelists will provide their perspectives on how companies operate within the complex area of Sherman Section 2 jurisprudence, including for some companies how they navigate not only the U.S. application of antitrust laws to single-firm conduct, but that of the diverse antitrust regimes around the world.

Our panelists this morning are David Balto for the Generic Pharmaceutical Association, Patrick Sheller from Kodak, and Ron Stern from G.E.

Our format this morning will be as follows. Each speaker will make a 20- to 25-minute presentation. We will then take a 15-minute break. After the break, we will reconvene and have a moderated discussion with our panelists.

These hearings in Chicago are an important component of the joint FTC and Antitrust Division hearings on single-firm conduct under Section 2 of the Sherman Act. They are designed to identify areas where single-firm conduct is causing competitive harm, areas where antitrust enforcement may be chilling desirable activity, and areas where additional guidance would be most valuable.

FTC chairman, Deborah Majoras made it clear at the opening session of these hearings that she wanted to hear from businesses, either through their executives or their legal advisers. As Chairman Majoras said, and I'll paraphrase, we want these panels to discuss business conduct from the market perspective from the ground up. That is, examine why and when firms engage in it, how they do it, and what effect it produces for the firm, for other firms, customers and competitors and for consumers. We want these discussions to include knowledgeable business people or their legal advisers.

Over these last eight months we have held hearings on specific types of business conduct, such as predatory pricing, refusals to deal, bundled and loyalty discounts, tying arrangements, exclusive dealing, and misleading and deceptive conduct.

Some of these panels have included business executives or their legal advisers. In addition, we've covered some general areas, such as business strategy, business history, and economic empirical studies.

The sessions today are designed to further FTC Chairman Majoras's goal to obtain as much insight and real-world experience as possible from business representatives.

This is the second set of hearings that have specifically been devoted to obtaining testimony from company representatives and associations. The first set of business testimony hearings were in Berkeley, California on January 30th, 2007.

We look forward to hearing the panelists' comments and to the round-table discussion. I want to thank all of them for agreeing to participate in today's hearings. We know that it takes a lot of time to prepare for these hearings. So again, thank you for your time and efforts.

I would now like to turn it over to my colleague and co-moderator Joe Matelis from the Antitrust Division for any remarks he would like to make. Joe.

MR. MATELIS: Thank you, Jim. The Department of Justice's Antitrust Division is very pleased to participate in today's hearing. In the single-firm conduct hearings we have held to date, we have benefitted from the insights of many highly-skilled antitrust attorneys and economists.

Today's hearing, as well as the sessions held last month in Berkeley, California, grew out of the belief that we could also learn much about single-firm conduct from businesses. Our panelists today are the people who help devise and implement business plans, aware that their firm's unilateral conduct may be challenged in private or government litigation and by foreign competition authorities. Their companies are also directly affected by the conduct of other firms.

Whether you've had occasion to view Section 2 of the Sherman Act as a sword directed at the heart of your business or as a shield protecting you from anticompetitive conduct of others, we look forward to hearing from you today.

On behalf of the Antitrust Division, I would also like to take this opportunity to thank the Gleacher Center and the University of Chicago Graduate School of Business for hosting these hearings. Also on behalf of the Division, I'd like to thank David, Patrick, and Ron for volunteering your time today. We know that these hearings take a lot of effort, especially when traveling to Chicago in February. And we're very grateful for a valuable public service that you're rendering. Finally, I'd also like to thank Jim and Bill and their colleagues at the Federal Trade Commission for all their hard work organizing today's hearing. Thanks.

MR. TARONJI: Thank you, Joe.

Our first speaker this morning is David Balto. David Balto has practiced antitrust law for over 20 years, both at the Federal Trade Commission and the Antitrust Division. At the FTC he was the attorney adviser to Chairman Pitofsky and assistant director for policy and evaluation in the Bureau of Competition. He helped guide many of the FTC's pharmaceutical and health care enforcement efforts, including challenging patent settlement agreements.

David has written extensively

on antitrust and health care competition and is the vice chair of the ABA Antitrust Section Federal Civil Enforcement Committee. He graduated from Northeastern University School of Law and the University of Minnesota. And David is speaking today on behalf of the Generic Pharmaceutical Association. David.

MR. BALTO: Thank you, Joe. I want to express my privilege for -- to come here and testify in these hearings. And I want to mention on that that my remarks today are my own and don't necessarily reflect the remarks -- should not necessarily be attributed to the Generic Pharmaceutical Association or any of its members.

Let me set out the outlines of my testimony. I want to start off with one indisputable fact, hopefully indisputable fact, the importance of generic competition in the market.

I'm then going to try to talk about how pharmaceutical markets are different than other types of markets and why that should make a difference in the analysis of single-firm conduct.

I'm then going to talk about two forms of anticompetitive conduct by branded pharmaceutical companies and how those forms of conduct should be analyzed, and then perhaps close with some suggestions. Let me begin with the indisputable.

Generic competition benefits every consumer in the United States. Generic drugs sell for about 70 percent less than branded drugs. They account for 56 percent of all prescriptions and less than 13 percent of all pharmaceutical expenditures.

The last time TEO studied this issue in 1994 they found that generic drugs saved consumers between 8 and $10 billion a year at a time when generic substitution was vastly lower than it is today.

Antitrust enforcement in the generic drug industry is essential. Let me put this into context. Today you can walk out of this hearing room and go to your local pharmacy and buy a generic form of Remeron, Relafen, Buspar, Taxol, Augmentin, Paxil, Coumadin, and Platinol. For each of these drugs, the branded pharmaceutical firm, a dominant firm attempted to extend its monopoly through some form of alleged exclusionary conduct.

In some cases they filed sham petitions before the FDA. In some cases they engaged in sham litigation. In other cases they engaged in inequitable conduct before the Patent and Trademark Office.

All together, these drugs accounted for more that $10 billion of purchases by U.S. consumers. And because of enforcement actions taken by the Federal Trade Commission, the state attorneys general, and private antitrust attorneys, these actions were stopped. And today's consumers save billions of dollars because of those enforcement actions.

Policing exclusionary conduct by branded pharmaceutical companies could not be a greater priority. In the next four years, over $60 billion of branded pharmaceuticals will go off patent. Unfortunately, the pharmaceutical industry offers many opportunities for dominant branded firms to manipulate a highly complex regulatory system to secure monopoly profits, not through superior foresight, industry, and innovations, but by finding loopholes to delay competition.

Now, let's start off with why pharmaceuticals are different. Now, my colleagues on the panel today are going to talk about the need for simple rules. They're going to talk about the need for going and creating bright-line tests so it will be easier for their business people to do what they're supposed to do, compete in the marketplace. As an antitrust practitioner, I can appreciate their perspective.

However, I think that the Commission and the Antitrust Division should be extremely cautious about simple rules for dominant firms. As Justice Scalia has observed, the conduct of a dominant firm is viewed through a special lens. Behavior that might otherwise not be of concern under the antitrust laws can take on exclusionary connotations when practiced by the monopolist.

Now, I think there are four factors in the pharmaceutical industry that should make people cautious about bright-line rules in this industry. First, pharmaceuticals are heavily regulated; and as my testimony sets forward, this provides a remarkable number of opportunities for engaging in what's been called by the FTC cheap exclusion.

Second, who is the buyer? Now, knowing who the buyer is is critical to defining markets and determining market power and also oftentimes to determine whether or not certain parties have standing. But in the pharmaceutical industry is the ultimate buyer the consumer, the insurance company, the pharmaceutical benefit manager, the physician who prescribes the drugs, or a combination of all of these?

Third, pharmaceuticals have high fixed costs but very low average variable costs. And so when my colleagues today go and talk about bright-line rules for predatory pricing, those might not apply that well in a setting with that kind of cost structure.

Then finally, forms of distribution are complex. Pharmaceuticals are distributed through all these numerous different intermediaries, and not all distribution mechanisms are the same. Maybe in the questioning period we'll go and talk about distribution exclusivity cases where I can address some of these ideas.

Now, I want to talk today about two form -- fortunately through a combination of the FTC's and State Attorneys General enforcement actions, the FTC's advocacy to Congress, Congressional legislation, many of the recipe -- the recipe book for anticompetitive conduct by dominant pharmaceutical companies has basically been thrown out. But like all good cooks, the pharmaceutical companies have come up with new forms of anticompetitive conduct, and I wanted to talk about two of them today to illustrate the importance of a couple things, the importance of antitrust enforcement, the importance of a balanced rule of reason analysis in looking at exclusionary conduct and staying away from per se bright-line rules. And those two types of conduct are product line extensions and abuse of the regulatory process.

Now, let me explain product line extensions. As in any other area, there are changes in products. We all try to improve our products. One of the key things to remember here is that for a generic firm to enter, it is essential for there to be a branded firm that is listed and been approved by the Food and Drug Administration. And the way this process almost invariably works is that the generic firm goes and copies a branded drug. The branded drug goes off patent or the generic firm prevails in patent litigation, and then the generic firm enters.

But sometimes the product line extensions can have anticompetitive effects. The FTC recognized this in the merger of Cima and Cephalon. Cephalon made a branded drug that was used to treat pain when you underwent cancer treatments. It was acquiring Cima which was developing an alternative product. The FTC uncovered in the course of its investigation that part of the reason for the acquisition was a product-switching plan by Cephalon. They planned, once they acquired Cima, to go and take the Cephalon product out of the market, to delist it. And in fact, that would have prevented generic firms from being able to enter the market for this drug.

In order to resolve the competitive concerns posed by this merger, the FTC required Cephalon to sponsor generic entry on the form of that drug that it manufactured.

Now, if you were to read one case in the area of pharmaceutical antitrust, I suggest you read the case of Abbott versus Teva. Now, this case will remind you of the cartoon in Peanuts where Linus keeps coming up to try to kick the football. And every time Linus goes and tries to kick the football, Lucy picks up the football, and he misses it and falls flat on his back.

There's a drug called Tricor

which is used to lower cholesterol. It's am almost billion dollar drug. Impax and Teva were developing a generic alternative. Each time they were poised to enter, the branded pharmaceutical manufacturer made some small change to the product, thus preventing them from being able to enter. The last change was changing the product from a capsule version to a tablet version. The tablet version was supposedly superior because it didn't have to be taken with food.

But Abbott didn't just change the product. After the tablet formulation was approved, it stopped selling the Tricor capsules. It bought up all the excess Tricor capsules. And then there's this important register. It's called the National Drug Data File. And the only way you can get a generic drug into the market is if it's listed in the NDDF. And what Abbott did is it listed -- changed the code for Tricor capsules in the National Drug Data File to obsolete.

Anyway, so let's go to the litigation. Abbott and Teva sued, along with a group of buyers of drugs. And the defendants basically say, you know, this is a product improvement. There is no role for antitrust here. There is a per se legal rule. In order to demonstrate a violation, they would have to show that quote: The innovator knew before introducing the improvement into the market that it was absolutely no better than the prior version, and that the only purpose of the innovation was to eliminate the complementary product of a rival. That was the standard articulated by Abbott.

And you know, there was case law that supported Abbott's position, though not in the pharmaceutical industry. Now, rather than adopting the rule of a per se legality, the Court went back to the test articulated by the D.C. Circuit in Microsoft which suggests a rule of reason balancing test. And it said the per se rule as proposed by the defendants presupposes an open market where the merits of any new product can be tested by unfettered consumer choice. But here, consumers were not presented with a choice between the products. Instead, they eliminated that choice by removing the old formulations of the products.

Now, I know my colleagues on the panel, their hair is about to stand up at this point because what this Court has basically suggested is that there is a duty to deal. That a dominant firm in some sense has some kind of obligation, a duty to deal, with its rivals. How could that be? Well, let's see what the Court said.

It said, A co-monopolist is not free to take certain actions that a company in a competitive or even oligopolistic market may take because there is no market restraint on a monopolist's behavior, harkening back to Justice Scalia's idea that I mentioned before.

So in this case where the dominant firm went beyond a simple product innovation, but also created obstacles for the other firms to effectively enter the market, that was a violation.

Now, there's a similar case

in the E.U. and in Canada involving Astra Zeneca, the drug Lobec. In this case violations were found in both of those jurisdictions. In that case what happened was as the patents on the drug were expiring, Astra Zeneca filed for additional patents, but these were patents that really weren't used on improving the drug. These were just additional patents to create the additional obstacles. And again, antitrust violations were found.

The most interesting case here is a case that was just filed in the past year or so, and it involves the very well-known conversion of the drug Prilosec to Nexium as Prilosec was losing its patent protection. This again involved Astra Zeneca. This is something like a $4 billion-a-year drug.

In the alleged anticompetitive conduct it was said, up to 18 months before Astra Zeneca was about to lose exclusivity it stopped promoting the drug, and instead, started to make negative claims about the drug. Now, I don't know about you or me, but I just don't know when people start making negative claims about their drugs.

More important than just creating Nexium, they also effectively withdrew Prilosec from the market, so it was impossible for managed care organizations to go and sort of continue to contract for Prilosec.

And so when generic Prilosec was about to arise, there was no possibility for it to substitute for branded Prilosec.

And one of the most interesting issues and maybe something worth discussing later on is the fact, as alleged, that Nexium was no improvement on Prilosec.

Let's go on to the issue of petitioning and litigation. You know, one of the most important achievements of the Federal Trade Commission has been the focus on sham petitioning and the use of regulatory processes to create competitive harm. Probably the case in which they've brought the most consumer benefits was the Unocal case in which it attacked sham petitioning by Unocal before the California Resources Board that costs consumers in California over $500 million annually.

Sham petitioning is a serious problem. As the FTC's recent staff report on the Noerr-Pennington Doctrine observed: One of the most effective ways for parties to acquire or maintain market power is through the abuse of governmental processes. The cost of the party engaging in such abuse is typically minimal, while the anticompetitive effects resulting from such abuse are often significant and durable.

Anticompetitive conduct through regulatory abuse can be especially pernicious if, God forbid, Kodak or GE were to engage in any kind of abusive conduct. If they exploited their dominant power, it would be short lived. Why? Because there are numerous firms poised to go and battle them for that role of king of the hill. But when your job as king of the hill was gained through abuse of the regulatory process, no natural force can displace you. That's why abuse of the regulatory systems is so pernicious.

This is especially the case in the pharmaceutical industry. The cases I identified at the beginning of my testimony were cases which were largely based on abuse of the regulatory system.

Almost 30 years ago, Judge Bork observed that predation by abuse of governmental procedures, including administrative and judicial processes, presents an increasingly dangerous threat to competition.

No statement could be more on point for the anticompetitive conduct in the pharmaceutical industry and the practice of so-called citizen petitions. The FDA, like many regulatory agencies, offers the opportunity for citizens to petition them to raise questions about safety and efficacy and other issues. And that process is obviously well intentioned, but it's abused to an increasingly significant extent.

What happens is again, when a generic company is poised to enter the market, the brand company will file a frivolous petition on the eve of FDA approval. That may be despite the fact that the FDA may have granted a tentative approval, that maybe despite the fact that similar petitions have already been filed. The brand strategy is just simply delay the generic drug from the market. And you can imagine when you're talking about drugs in which the amount of profits amount to 10 to $20 million a day, this could be a very attractive opportunity.

The FDA citizen petition process provides significant opportunities for deception. There are no requirements for proof of the accusations made in the petition. No requirements for certification of the accuracy of the information. There are no penalties for inaccurate or improper filings. There are no limits on the number of filings that may be filed. Some petitions contain little or no evidence or rely on obsolete, irrelevant, or erroneous information.

The FDA has even noted the fact that they've seen several examples of citizen petitions seemingly designed to delay the approval of generic approval.

So let's look at the numbers. You know, if I wanted to make it to Wrigley Field this spring, if I wanted to join the Cubs for spring training, I'd want to have a pretty good batting average. Otherwise, they wouldn't look at me.

What's the batting average on citizen petitions? Since the Medicare Monitorization Act was passed in 2003, there have been 45 citizen petitions filed challenging the conduct trying to delay the entry of generic drugs. 45. 21 of these have been resolved. One has been resolved in the favor of the petitioner. One. 20 have been denied.

Now, if I'm batting at .05 percent, I'm not going to get much of a try-out at Wrigley Field this spring. None of the last-minute -- many of these petitions were filed within the four-month period prior -- half of them were filed in the four-month prior period to the entry of the drug. Did any of those succeed? None. Not one.

Well, how much do they delay

things? Those late-filed petitions delayed things an average of ten months. And in one case, the amount of delay cost consumers an estimated $7 million a year.

Is this a small problem? No. According to the statistics of the FDA, there's been a 50 percent increase in the number of citizen petitions they have received. And there are about 170 citizen petitions pending compared to only 90 in 1999.

Now, one of the most illuminating observations of the FTC report on the Noerr-Pennington Doctrine was its observation about how serial sham litigation conduct should be analyzed. I think the FTC should go and apply the ideas that it has and the expertise it's developed, both in that report and in its enforcement action in Unocal to give a very serious look at the citizen petition process. Let me conclude.

Antitrust plays a vital role in maintaining rivalry as the lone star of the marketplace. Competition is critically important where many of the factors identified earlier can forestall competition.

The FTC, State Attorneys General, and private antitrust lawyers have played an important role in protecting pharmaceutical markets from artificial barriers to competition, and I hope these hearings keep Section 2 as a robust statute so that it can continue to be used to protect the interest of consumers and competitors in this vital market. Thank you.

(Applause)

MR. TARONJI: Thank you, David. Our next speaker is Patrick Sheller. Patrick is the chief compliance officer for Eastman Kodak Company. In that capacity he is responsible for Kodak's code of conduct and internal investigations.

Prior to his current assignment, Patrick held a variety of business positions and was Kodak's chief antitrust counsel and also was involved in legal matters in Europe.

Prior to Kodak he was in private practice with a law firm that is now known as McKenna, Long & Aldridge, and is a former Federal Trade Commission attorney, having worked in the Bureau of Competition and as attorney adviser to Chairman Daniel Oliver. He is a graduate of St. Lawrence University and the Albany Law School at Union University. Patrick.

MR. SHELLER: I want to thank the Department of Justice and the FTC for the opportunity to speak to you today. It's an important time in antitrust law for our economy, and it's a particularly important time for Kodak. I suspect one of the reasons we were invited to participate in these hearings is Kodak's well documented experience with the Section 2 enforcement which began in 1921 when an investigation by the Department of Justice was settled through a consent decree which prohibited Kodak, among other things, from selling a fighting brand of consumer film, also known as private-label film.

In 1954 we settled an investigation with the Department of Justice. This matter involved alleged tying of consumer color negative film with photo processing services. Under this consent decree we were prohibited from selling these two items under a single price.

In 1979 our luck turned a bit. We benefitted from a primarily favorable ruling by the Second Circuit in the Berkey Photo case where one of our competitors challenged Kodak's introduction of the 110 photographic system that included a camera, specially formatted film, and a new photo processing service.

One of the key rulings in that case was that a monopolist has no obligation to predisclose new products to a competitor. And, to the extent that a monopolist engages in truthful advertising, that conduct does not offend Section 2.

In 1991 our luck turned in the other direction again with the Supreme Court's decision in the ITS v. Kodak case. This was an action brought by independent service organizations that were competing against Kodak in the service of photocopiers and micrographics units. It was in the ITS case that the court established the so-called single-brand derivative aftermarket; the notion being that once a customer chooses to purchase an expensive item of capital equipment, they're now locked into that particular brand or manufacturer. Whether or not that manufacturer has market power in the primary market for photocopiers, for example, was determined to be irrelevant to the Supreme Court. The ITS case went back to the trial court on remand, and I'll speak more to the trial in a minute.

In 1994 Kodak challenged some aspects of the 1921 and 1954 consent decrees. We were successful in overturning the private label restriction and the prohibition on linking film with photo finishing sales, primarily because we were able to demonstrate to the District Court and to the Second Circuit that market conditions had changed significantly.

By 1994, Kodak was competing on a global basis with a number of foreign suppliers as opposed to the market conditions that existed when these consent decrees were entered into.

Finally, in 1996 the Ninth Circuit heard Kodak's appeal of the jury verdict in the ITS case. The jury found that we had engaged in an unlawful refusal to deal by refusing to provide patented and copyrighted parts and copyrighted diagnostic software and manuals to ISO's.

The key ruling in that case, for purposes of my remarks today, was that an IP owner faces restrictions on its ability to refuse to deal with ISOs by refusing to license its IP.

The Ninth Circuit picked up on the First Circuit's decision in the Data General case in holding that there is a presumption in favor of an IP owner, that it has a legitimate business justification for refusing to deal with a rival. But that presumption can be overcome by evidence that the IP owner had an anticompetitive intent. The 9th circuit's ruling essentially opens the door to ISO's to come up with evidence in the form of internal documents showing that the IP owner was trying to keep out competition through its decision to refuse to deal.

Now, the history of Kodak's experience with Section 2 parallels in many ways the evolution of our company, our technology, and our business model. Beginning in the 1880's and through the 70's, the focus of our business was on consumables. We primarily sold film products, paper products, and chemicals. We engaged in the sort of razor/razor blade model of selling cameras in order to generate more film sales.

The company began to diversify its portfolio in the late 60's to 1970's, and we began to offer more expensive items of capital equipment such as photocopiers, micrographics equipment, and graphic arts equipment. And in this sense our business model began to change to offering hardware plus aftermarket service. It was in this context that the ITS case arose.

We are now in the process of a monumental shift in the business model of our company as we try to become a digital company as opposed to an analog technology player.

The focus of our business going forward is going to be on selling solutions. Solution selling is very common in the digital world where companies will bundle a portfolio of offerings that include hardware, software, consumables, consulting services, and aftermarket service into a single price to sell to customers who demand an end-to-end solution.

Our sales focus going forward will be on digital products such as photo printer kiosks, image centers. We announced last week the introduction of a new line of consumer ink-jet printers, which means Kodak will now be competing in a new market. We will also offer Digital cameras, media ink, and so forth.

Elements of the old business models still remain at Kodak. We will continue to sell film. But our focus will be on solution sales, and there will be be a real emphasis within the company on the ability to sell in this environment.

We face a number of challenges as we try to participate in the digital world. Some critical success factors to our new digital model are, first of all, that we rapidly innovate and develop new technology to commercialize new products. Digital companies constantly introduce new versions of their products. We have to keep pace in this fast-moving environment. And in that sense, intellectual property has become increasingly important to Kodak.

We need to be able to protect our research and development investments, wherever possible, through patents and copyrights, and we need to be able to protect these assets in a way that doesn't offend the antitrust laws.

One of our key strategies going forward is to monetize our intellectual properties. Kodak has, for the last several years, entered into numerous licensing agreements with other digital players in the industry, and we need to be able to go about that licensing activity without fear of antitrust concerns, as I'll talk about in a few minutes.

And finally, as I mentioned,

solution selling is critical to our success in the digital world. A good example is our graphic communications business which sells graphic solutions to printing firms. These solutions include software, work-flow software, hardware, consumables, consulting services, and aftermarket service.

So what are some of the Section 2 impediments to our success in this new digital world? First of all, we would encourage the antitrust agencies and the courts to recognize the importance of market changes. As we saw with our attempt to overturn the 1921 and 1954 consent decrees, we were forced to litigate with the Department of Justice over the issue of whether Kodak was competing in a worldwide market versus a domestic market.

And to the extent that further challenges arise to our practices in the film environment, we would encourage the agencies and the courts to recognize the substantial influence of digital technologies on markets that were previously dominated by film.

As we saw literally overnight earlier in this decade, our film business began to decline dramatically in the year 2001. We initially thought it was a result of reduced demand following the 9/11 attacks, but the market never came back. It was because many customers had decided to convert from film to digital. And many customers that make this conversion never come back to film.

Another impediment to our success in the digital world relates to the antitrust line between tying and bundling. This line is becoming increasingly blurred as a result of the LePage's and other decisions, which I'll speak to more in a few minutes.

Finally, obstacles to our ability to monetize our intellectual property investments exist in the form of cases like the Ninth Circuit's decision in the ITS case and precedents in the European Union such as the McGill case and the INS Health case where the Commission required compulsory licensing licensing by intellectual property owners.

Let me first turn to the LePage's decision and the uncertainty that case has left companies like Kodak with. While the Third Circuit had an opportunity to clarify the application of Section 2 in the area of bundled discounts, in our view it squandered that opportunity by deciding the case on its narrow set of facts. The court ruled said that 3M's practice of bundling its branded Scotch tape with both private-label 3M tape and with other 3M products caused injury to its competitor, LePage's, and therefore offended Section 2.

The only parameters that we are able to draw from the LePage's decision in terms of an alleged monopolist's ability to engage in pricing activities are, first of all, that single-product volume discounts are permissible. The court made that clear. But what's at risk following the 3M/LePage's decision, are discounts linking products across multiple markets where an alleged dominant product is involved, and also discounts linking a dominant product with others across a single product line, such as the linking branded and private-label tape. We are left with no coherent standard with which to evaluate bundled pricing under the LePage's decision.

We would submit there were better alternative paths that the Third Circuit could have taken in evaluating the case against 3M. The Eighth Circuit's decision in Concord Boat applied the Brooke Group decision by the Supreme Court to find that as long as single-product discounts are above cost, they should not be considered exclusionary under Section 2.

It would have also been helpful if the court had given some thought to the Ortho Diagnostic's Systems case by the Southern District of New York where the court articulated its analysis of the alleged bundling by asking whether an equally efficient competitor to the monopolist could profitably match the bundled price the in the market. That would have been an arguably more rational test to apply.

While we could previously rely on the very clear distinction between tying on the one hand where a monopolist tries to force the purchase of a second non-monopoly product, we now have to deal with a precedent that articulates no coherent standard such that bundled discounts now come under scrutiny. As I said before, bundling is very important to our ability to offer solution sales.

Turning to the issue of IP rights, as I mentioned, a very important strategy of Kodak going forward is our ability to monetize our IP portfolio. The Ninth Circuit's decision in the ITS case has had a a chilling effect on that activity. There the Court held that although there is a presumption in favor of an IP owner's right to refuse to license a competitor, that presumption can be overcome by evidence of bad intent. And that evidence can take the form of internal company documents.

We think that the Federal Circuit, which considered very similar facts in the Xerox v. CSU case got the issue right when it held that in the absence of tying, fraud or sham litigation, it's not appropriate to inquire into the IP owner's subjective motivations for asserting a statutory right to exclude. The Xerox court held that the same rationale would apply to asserting copyright protection as the basis for a refusal to deal.

As a result, we have a clear split among the circuits that has created a great deal of uncertainty on the part of the IP owners and companies that provide aftermarket service.

Where does the uncertainty in these two areas leave Kodak and other companies? First, if we're successful with our digital strategy, and we're able to achieve a leading market position in some of the new digital markets where we participate, our ability to offer competitive bundled pricing could be constrained by the LePage's decision. As I said, bundled pricing is really the essence of solution selling.

Second, notwithstanding a lack of market power in the primary equipment markets in which we compete, we still face potential challenges by ISO's that can allege that Kodak dominates a single brand aftermarket for a particular line of equipment. Such ISOs will try to require us to license or sell our valuable intellectual property.

Let me offer a few examples of the dilemmas these ambiguities can create, and these are hypothetical examples. First, sell a line of photo kiosks that you may have seen at a number of retailers. A question arises as to whether Kodak can offer retailers bundled discounts on the kiosks, our paper that runs through these kiosks and the aftermarket service. Could we also include digital cameras in that bundle when we sell to retailers? Could Kodak refuse to license our valuable diagnostic software on these photo kiosks to an ISO that wishes to compete with us?

Turning to our intellectual property strategy. We are in the process of entering into licensing agreements with a number of companies that we believe have infringed our patent portfolio in the digital camera area. The question arises whether, in approaching a particular company we believe violates our patents, can we refuse to license the companies' rights in our patents simply because they are competitors. And does that situation get any worse because we've got an internal document suggesting that a reason for refusing the license was to gain an upper hand in the marketplace.

Could we, in licensing to other digital camera sellers, bundle Kodak software that allows customers to view their images on a PC?

We offer an on-line photo service where you can upload your photos and order prints or order prints on different items like T-shirts and coffee mugs. This is called the Kodak Easy Share Gallery. The question arises whether in the event we were to gain a leading market position with our Kodak Photo Gallery, we could say to our customers who agree to store a fixed number of images on our site that they will get a discount on their prints?

And finally with respect to our graphics business, which I mentioned is very much focused trying to meet the end to end work-flow demands of our customers, are there antitrust concerns with our selling graphic communications equipment, software, consumables, consulting services, and aftermarket services as a bundle? Should it make a difference that our customers demand such solution sales?

These are some of the issues that we grapple with in light of the uncertainty under Section 2 that I've outlined, and I'll look forward to further discussion on these and other issues when we get to the questioning period.

(Applause)

MR. TARONJI: Thank you, Patrick. Our next speaker is Ron Stern. Ron is the vice president and senior competition counsel for the General Electric Company. Ron received his AB from Brown University and his law degree from Harvard.

He clerked for Judge Harold Leventhal of the U.S. Court of Appeals for the D.C. Circuit and for Justice Potter Stewart of the U.S. Supreme Court. He was in private practice with Hughes, Hubbard & Reid and was a partner with Arnold & Porter.

In addition, he was the special assistant to the Assistant Attorney General for the Criminal Division of the U.S. Department of Justice. Ron.

MR. STERN: I'd like to

begin by thanking the Antitrust Division and the Federal Trust Commission for holding these hearings and for providing me and others with the opportunity to address important issues relating to the application of the antitrust laws to single-firm conduct.

In particular, I would like to thank the staff at both agencies who have organized these hearings and put in the hard work required to make them a success.

I also want to make clear at the outset that the views and opinions that I am providing today and that are in the written slides are my own personal views and not those of the General Electric Company or of other General Electric officials.

Let me begin with an overview. I want to agree with the heads of the two agencies that are hosting these hearings, the Assistant Attorney General and the Chairman of the Federal Trade Commission, that it is important to have clear, administrable, and objective rules. This is a key requirement, something that's really at the heart of these hearings.

It's important for business to avoid chilling procompetitive conduct. It's also important for consumers. It's important to help avoid inadvertent violations and disputes and investigations that end up wasting company time and resources as well as the time and resources of the agencies.

And finally, it's important to reduce the cost of developing and implementing business plans to foster competition in the marketplace.

Now increasingly, as the economy globalizes, it's not sufficient that the U.S. rules are clear. The rules adopted by other jurisdictions will, of course, affect U.S. commerce. And I do not believe that it is surprising or coincidental that the United States, European Commission, and the International Competition Network, an organization formed by, I believe, more than 100 competition authorities around the world, are all addressing the issue of competition standards for single-firm conduct at this time.

In a global economy this is a global issue, not just a United States issue; and that's important, particularly for companies such as mine, that operate in a number of global markets.

What I'd like to do today is walk through from a counseling perspective which is a perspective, I see every day, and look at areas that could be clarified in Section 2.

First, the issue is what kind of rule governs. Is your conduct unilateral, single-firm conduct, or is it multi-firm conduct? Is it something that Section 1 governs or Article 81 in Europe?

Or is it something that Section 2 governs as single-firm conduct or Article 82 in Europe?

The next issue is whether there is a threshold solution or a threshold screen that makes you comfortable that the conduct doesn't violate the law? And one important screen under the U.S. law is the requirement of monopoly power.

If you can be sure that your

company isn't in that kind of position, it doesn't control market prices, then you don't have to worry about the nature of the conduct and whether the conduct meets or doesn't meet any of the different rules that have been talked about during these hearings and are being discussed today.

If the threshold isn't met, then you have to look at the conduct and decide whether the conduct is exclusionary or not. And oftentimes what you're looking for are clear rules that will guide you to allow you to tell your client that they can safely pursue X type of conduct because that's in a safe harbor or that's clearly not a problem.

And then why are we going through this entire exercise? Well, we're going through the exercise basically because there are risks and costs if you end up in a gray area that someone thinks violates the requirements.

There is the potential for government enforcement actions and investigations, and in the U.S. for private treble damage action. And there are a host of potential consequences, from injunctive relief to fines, not in the U.S., but in some jurisdictions, to treble damage awards, legal fees, and the like.

So what I'd like to do is continue to walk through the issues. One issue that reinforces the concern that I'd just like to touch upon is the fact that jury instructions in the Section 2 area are often particularly problematic. I've just set some examples up on the screen, but basically they involve very general types of words. Is the conduct wrongful? Did one buy more logs than were necessary or pay a higher price than was necessary? Did the firm engage in competition on the merits? Whatever, again, a jury believes that means.

All of these things reinforce the risk, particularly in the U.S. environment, of treble damages and attorneys' fees and large litigation costs. You basically want to counsel to be in a safe zone to avoid having to worry about jury instructions.

So then back to the

beginning. Do you know whether you're in the single-firm conduct area? We obviously have the Copperweld decision and clear law that if you're a company and you're dealing with a wholly-owned subsidiary, you're one entity, and you know that you can't violate Sherman Act Section 1 by having an agreement in restraint of trade because you don't have two parties. You just have one.

The problem is under Copperweld the application is unclear. The law in the lower courts is divided as to where the line is when you're dealing with non-wholly-owned subsidiaries.

And one important thing that the government could do is reinstate the guidance that existed in 1988 with the antitrust enforcement guidelines for international operations. I've included that in the slides.

And the clear guidance that was given then, I think, would be important to reinstate it, is that whenever you have more than 50 percent of the voting securities of a company owned by its parent or its sister company, that whole family of companies is one economic entity and is subject only to Section 2, the single-firm conduct section, and not Section 1. That's one area in which I think clarity could be added.

Now, if we move beyond, the next issue is trying to identify whether your company in the particular situation that you're facing is subject to Section 2. And the first element of Section 2 is having monopoly power. The second element relates to the conduct. Is there a willful acquisition or maintenance of that power which is often referred to as engaging in exclusionary conduct.

Now, under United States law there is a pretty helpful screen. You have to have the power to control market price. And in bidding markets, it's clear that if there are other credible competitors, you generally don't have the power to control market prices, even if you have a very large share.

The case law gives some very

helpful general rules of thumb. If you have more than a 70 percent share, you have to look at all of the other factors, but you at least know that you're in a danger zone.

If you have less than a 50 percent share under the U.S. case law, it's very unlikely that you have to worry about whether your conduct could be categorized as exclusionary.

Some people point to the fact that attempted monopolization can occur at a lower market share threshold, but you have the very important counseling hook in the element of attempted monopolization which is the requirement of a dangerous probability of achieving monopoly power, which brings you right back to the monopoly power test.

So the key is, and I think that's been very helpful, even for successful firms, and certainly my company has a number of successful businesses, that most successful firms simply do not meet the monopoly power test under U.S. law. And that is helpful in counseling. But there are two important howevers that I want to talk about.

The first is the issue that's been discussed that Patrick talked about, the treatment of aftermarkets. And the second are non-U.S. issues, that there are lower dominance thresholds outside the U.S. And indeed, there is the curious concept of collective dominance, at least curious to a U.S. antitrust lawyer outside the U.S., so let me turn to those.

First I'd like to turn to aftermarkets. As Patrick mentioned, this comes from the Kodak case. There the Supreme Court held that there was the potential, not that it was always the case, but the potential for there to be a single brand parts and service market, even where the company had a modest percentage and had no monopoly power in the interband equipment market. Here, Kodak had less than 25 percent, clearly in the safe harbor of the interband photocopier market. Photocopiers are often referred to as Xerox machines, not Kodak machines. That's for a reason. They didn't have market power. But they had a very large share of an intrabrand parts and service market for Kodak copiers.

Now, post-Kodak, there have been a number of court cases interpreting Kodak, and they have limited Kodak's application in most circuits to a situation in which there has been a change of policy with respect to aftermarket sales of parts or service. That however has not been uniform. The Ninth Circuit is sort of an outlier.

All in all, what this does, I believe, is create very significant problems. All suppliers of capital goods are exposed today to the notion of having to worry about whether or not they fall under Section 2 when they deal with parts and services for the products that they sell.

And somewhat ironically, if you have a modest market share, you're one of the also-rans in the interbrand equipment market, you may have a higher share of your single-brand parts and service market for the very simple reason that third parties tend to focus on the most successful installed base products to develop non-OEM parts and non-OEM services.

So the competitor with ten percent in the interbrand equipment market may be more likely to have a monopoly share of a single-brand aftermarket than the leading firm in the interbrand equipment market.

So this is a problem and it's a problem because it chills conduct. If you're going to counsel, what it does is it really counsels you to adopt restrictive approaches from the outset and not change them. Because if you do that, you really don't have to worry about having a problem in this area.

I think the outcome is an incorrect one. It has been heavily criticized by a number of esteemed economists, many of which have either been former heads of the economic part of the antitrust division or the current head. Professor Carlton, Professor Shapiro, Professor Klein, and Professor Hovenkamp have all criticized the Kodak decision with respect to aftermarkets and suggested that it is unnecessary and unsound.

And the Department of Justice thought it was unsound in its amicus brief in Kodak.

So I think what should be clarified here is this notion of single-brand aftermarkets. That concept from Kodak should be overturned. The government should give guidance, and should file amicus briefs in courts to try to clarify the law in this area.

The same thing should happen in Europe. I have referenced comments by the International Chamber of Commerce that are on the DG Competition website with respect to the Article 82 discussion paper which give further reasons why there shouldn't be single-brand aftermarkets.

Let's then turn to the issue of monopoly power outside of the U.S. Here, the International Competition Network has a unilateral conduct working group, and it has a draft report in-progress for its next convention in Moscow. And what it has found by surveying competition authorities around the world is that generally, the presumption of dominance, which is essentially the non-U.S. equivalent of monopoly power, is set at a 33 percent to 50 percent level. Now, that's below what is essentially the U.S. safe harbor level.

And what it does, of course, in a global marketplace is tend to expose a much larger number of leading firms to the potential that you have to worry about whether your conduct is going to be characterized in these regimes as abusive, or if you use the United States approach, as exclusionary.

Now, there's one good thing. There's also a trend towards taking a behavioral approach, which is looking at the ability to set market prices, the same approach taken under Section 2 in the U.S., rather than a purely structural presumption based on market shares.

I'd like to turn to another problem that I think is one that should be addressed. It's not a huge problem today, but it's the concept of collective dominance.

The European Commission Article 82 discussion paper talks about the fact that there can be collective dominance simply in a oligopolistic situation. You don't have to have an agreement with your competitors as long as a small number of firms control a large combined share of the marketplace. Then they can act in a way that supposedly would abuse their collective dominant position.

My sense is that this has never been applied, as far as I know, but it raises a real counseling concern. What are you supposed to do if your rival raises price? If all the other rivals in an oligopoly do what they often do, and that is match the price increase, have you then committed and abouse of collective dominance?

If you have a policy of having exclusive distributors and other firms follow that policy because it's efficient, have you violated collective dominance? It's very hard to figure out how to counsel. This is something that again, isn't a real-world problem today, but I think should be one that is nipped in the bud so it doesn't become a real-world problem tomorrow.

And then secondly, there's a separate issue in the draft anti-monopoly law in China in which a firm that isn't a leading firm, and that's true of course in the collective dominant situation. If you're not the leading firm in the marketplace, generally you don't have to worry about unilateral conduct.

But if either an oligopoly situation presents a problem or under the draft law in China, if two firms have two-thirds of the market or three firms have three quarters of the market, and you're the second-ranked firm or the third-ranked firm in that situation, as long as you have more than a 10 percent share, it appears that all of the firms are treated as dominant and subject to the listed abuses.

This law hasn't been adopted. It hasn't been interpreted. It's not clear what this means, but it's out there and it poses a potential risk that it seems to me the U.S. authorities ought to address and I know in fact are addressing.

Let me turn to some of the issues of conduct. The first one I'd like to talk about are refusals to deal. And it seems to me that this is an area in which there is a real opportunity for clarity.

My colleague Mark Whitener testified in the July 18 hearings on refusal to deal and covered this at some length, I just want to hit the high points. I'll refer you to his testimony.

Basically, the law appears to have evolved that an unconditional refusal to deal, and from that I distinguish one that is conditioned on taking a second product, which is often referred to as tying, or a conditional refusal to deal which says you will deal with me, and you won't buy from anyone else, usually called exclusive dealing. Those things ought to be dealt with, in my view an exclusive dealing or tying. But if it's simply an unconditional refusal to deal, I decline to sell you the product, in those sorts of situations it seems to me there should be a per se lawful rule.

Now what the case law has evolved in the Trinko decision is a notion that the Aspen Skiing case is the outer limits. And the Aspen Skiing case involved a refusal to continue to deal after there had been a voluntary cooperation with the plaintiff.

And the problem that that approach creates is obviously it causes people to be incentivized not to deal in the first place. The concern would be if that's the law, you would never have had the all-mountain pass in Aspen in the first place because the party with the three mountains would have known not to enter into the cooperation because it could have been accused of violating Section 2 should it have wanted to reverse course later.

This creates perverse incentives, and there is of course the entractible problem of remedies. Courts simply aren't set up to deal with the situation of how does one decide what the terms should be, what the pricing should be. This is another reason why if there's a problem in this area, there should be legislation and essentially a utility commission set up. The antitrust laws and the court shouldn't be handling this.

The same thing, I think, is true of the essential facilities doctrine, which is just another way of dealing with unilateral refusals to deal. That doctrine has been questioned by the Supreme Court, but it seems to me the law could be clarified in this area because the Court simply didn't address it.

Let me then turn to another area that's already been talked about a lot today, and that is the area of bundled discounts. It seems to me that although in the afternoon session I know we're going to hear a bit to the contrary, that unlike predatory pricing, where there's some pretty good and clear guidance about not pricing below a measure of cost and the need for recoupment, that in the bundled discounts, the mixed bundling area, at the moment there is a real need for clarity.

So what I want to do is start with just asking some questions and suggesting some responses that might create clarity. The first one is can we identify types of market situations where there just isn't likely to be a problem.

And I highlight one of them, Professor Barry Nalebuff, someone who has written extensively about bundling, suggested that in certain circumstances, at least from an economic theory point of view, it could create issues. But he's been very clear that that only really happens in a market situation in which the seller sets one price for all buyers of the product. And it doesn't happen in a situation in which there is bidding on an individual customer basis or negotiation on an individual customer basis.

If in fact that's a valid distinction, having that kind of clarification would be very important. It certainly would be important for my client, which generally engages in negotiated sales of products rather than consumer products where you often set one price for all.

Then another area is simply do most of these cases really involve a situation in which what is being alleged is you have a company with monopoly power in Market A that is bundling in order to try to create power or effect a separate Market B.

If that's the case, then it seems to me that an attempted monopolization claim involving that second market is what is really involved, and you have to look at whether there is going to be a dangerous probability of achieving monopoly power in that second market. And others who have testified have noted the importance of showing not only a disadvantage to a particular rival in Product B or the competitive product, but also a realistic threat of creating monopoly power in that second product.

Now, after those threshold issues, I guess one of the other questions is what framework do you use to analyze these bundled discounts or mixed bundling. And one suggestion I guess I would like to throw out for discussion is that these cases should generally fall into one of two categories. They ought to either be analyzed as tying, or they should be analyzed as predatory pricing. Again, Professor Nalebuff had talked about an example in his testimony in which he said well, predatory pricing really doesn't apply in some of these kinds of scenarios because there can be no-cost bundling. And his hypothetical was one in which you took the monopoly product and you raised the price of the monopoly product well above the monopoly price, and then you bundled using the monopoly price as the price of the monopoly good in the bundle, and then you priced in the competitive product.

And he said in that circumstance, well, no one would actually take the monopoly product separately. Well, at least from my legal standpoint, most courts would treat that situation in which the second product wasn't economically available as a tying situation, in which you were simply not selling the monopoly product unless you also bought the other product in the bundle. And in that situation, particularly where you're involved with a second market, you should be able to deal with the screen of attempted monopolization. You also of course can solve the problem by making sure that the separate price is a realistic price so that you avoid tying.

It seems to me then the other cases are situations in which you really are giving a discount off of the monopoly price in an attempt to assist in the sale of the competitive product.

And that sort of situation, if that's what's really going on, you do have discounting or loss on what you could otherwise sell the monopoly product for. In that sort of situation then the issue should be a predatory pricing analysis.

Now one approach that sometimes is taken is to look at -- and it's been advocated, I believe, by Professor Muris in an earlier hearing -- the price of the bundle and compare it to the cost of the bundle. In some situations that may be an appropriate and realistic approach.

Some criticism of that I think by Professor Hovenkamp is a stylized situation in which you have a monopoly product with a large monopoly margin. And if I simply took that margin and didn't bundle it, but simply took those profits and used it to discount the price of the competitive product, I might clearly be pricing the competitive product below my cost for that product.

And I think the question is why should the bundle situation be treated any differently than the straight predatory pricing discount on Product B.

In that stylized situation in Product B, Professor Hovenkamp advocates in the Ortho approach of attributing all of the bundles -- all of the discounts to the competitive product, and if that's still above cost, I think provides a helpful screen and safe harbor. That's one area where there should clearly be clarification.

But I think Professor Muris pointed out several important qualifications.

It's a highly stylized situation in which there is no competitor. There is an absolute monopolist, and there is no one else selling Product A.

When there are fringe sellers of Product A, those fringe sellers can help undermine the bundled price for the package.

There may also be situations in which there is a bundle with two competitive products, and it may be that the plaintiff can only sell one of those, but some other party can sell the second competitive product. They can team together and provide their own bundled discount. Or particularly, when you've got sophisticated customers, the customers can search the marketplace and provide their own added ala carte bundles. They will look at the price of Competitive Offer X and Competitive Offer Y and compare it to the bundle.

So this notion that it's a problem if you ascribe all of the discount to the price of the single competitive product that perhaps the plaintiff or the complainant is selling, I think is -- again, it's an over-dramatic case. It shouldn't be a problem if in doing that the resulting price would be below cost. It shouldsimply be a safe harbor if you're not below cost.

And then of course in these situations since there's a loss, you really ought to be able to look at recoupment. You have to really look at that just like you do in predatory pricing.

If you're losing money by subsidizing the sale essentially of the competitive product, how are you going to make that back? And if you're not going to force people to exit and if you're not going to be able to later raise price in that second market, the B market, the competitive market, then there's not a prospect for recoupment. And just because you have multiple products, it shouldn't be treated any different than Brooke Group, and you shouldn't have a violation.

Real quick, I just wanted to raise some questions about the 3M LePage's case that Patrick talked about. In that case, the case was litigated on the assumption that there was only one market involved, a market for transparent tape.

If in fact it had been litigated on the assumption that there were two markets, a market for branded tape and a separate market for generic or unbranded tape, then would there have been a violation? Remember, the record showed that the plaintiff, LePage's, still had two thirds of the generic type sales. Would there have been a dangerous probability of success of achieving monopoly power in that second market?

And if it's only one market, I think one has to go back and look at Professor Muris's suggestion that you look at the cost of the bundle. Remember it's all the same market. It's just two different products in that market. And if the cost of the bundle in that one market is above -- excuse me -- the price of that bundle is above the cost of the bundle, should that be a safe harbor in the single-market situation?

And then separately, if it's all one market, would the same result have been achievable just by discounting the branded tape that was clearly sold at a large margin above cost. But if we're assuming it's one market and you've lowered the price of the branded tape, presumably that would have applied the same pressure to LePage's the generic tape. Yet that clearly would have been appropriate under Brooke Group. You're not required to charge the monopoly price. As long as you're just giving discounts on a single product, that would be lawful. Would that have had the same effect in LePage's?

And then I think finally, an important part of this discussion -- and I think it goes broader than that case. This case is an example -- is what is achieved by the rule. What would have been accomplished? Would it have led to less discounting by 3M? How do you deal with situations in which you have leading or successful firms that you want to compete on price?

If the only rule is that you must discount on a product-by-product basis, that may result essentially in less price competition and may harm consumers because, as people have speculated, 3M probably was attempting not to reduce the price of its successful branded tape, but trying to find a way to incentivize customers to buy more rather essentially than to switch their purchases from branded tape to the 3M generic tape.

If in fact you have rules that limit the flexibility for leading firms, you have to look at what the economic consequences are going to be in the marketplace and for consumers.

I think this highlights one of the key areas. The hardest areas, I believe, are situations in which you've got a firm that meets the monopoly power situation, and it engages in conduct that someone wants to characterize potentially as exclusionary. Is that simply enough? What kind of impact is necessary or harm to competition is necessary? Is a scintilla enough, or does it have to be actually a significant harm to competition, or are you simply into a balancing test of what is the benefit versus what is the harm?

Now, very quickly I'd like us to cover one more point, which is on exclusive dealing, another area that could be clarified, and it does come up in the counseling context often. And that is a situation in which there would be exclusive dealing, which in a variety of contexts might be viewed as exclusionary conduct, but the exclusive dealing is at the behest of the customer. The customer comes and says, I think the best way to get the best price and the best terms from my suppliers is to hold a winner-take-all competition. So I'll invite everyone in and say, I'm going to buy all of my needs for the next three years from the party that gives me the best offer. And in that situation, I don't believe that even if you're the leading firm and even if you have monopoly power there should be a problem in competing and winning that kind of contract.

And it seems to me that kind of clarification will assist in counseling and will assist customers in getting the best deal they can in the marketplace, which is what the antitrust laws are designed to promote.

So in conclusion, I want to reinforce where I began. Clear administrable and objective rules are extremely important, and I hope they are the output of these hearings.

I made several modest suggestions about ways in which the rules could be clarified. The first would be to clarify Copperweld so that you know when you're engaged in single-firm conduct. Whenever you've got more than a 50 percent share of the voting securities, the parent and all of those subsidiary corporations should be one company.

Secondly, the aftermarket exception, the monopoly power rule. The notion that there are single intrabrand parts and service markets creates lots of counseling problems and lots of issues, I think, for consumers and competition. I think that ought to be overruled. And I think that the DOJ and the FTC should advocate that.

I think all unconditional unilateral refusals to deal should be treated as per lawful, whether they involve intellectual property or not. That should be clarified. That should be advocated to the courts. That should be advocated in international settings.

There are a number of ways I suggested in which the treatment of bundled discounts could be clarified. And finally, this idea of customer-initiated exclusive, I think a very simple, straightforward, helpful, practical clarification.

Then I just want to underscore I think it's very important that we take the step of clarifying the U.S. law both at the Agency level for their enforcement discretion to go the next step which both agencies have done an excellent job of moving the agenda in the courts through amicus brief process and getting a number of key clarifications. I hope there are more at this term with the cases that are pending.

And then finally, continuing

to be active in bilateral discussions with other competition authorities and being a leader in the international competition network. Thank you.

(Applause)

MR. TARONJI: Thank you, Ron. We're going to take a 15-minute break and be back here at 11:15.

(Break taken)

MR. TARONJI: Well, thank you. The first thing I would like to do is offer each of the presenters an opportunity to comment on what they've heard from the other panelists. Let me start in order. David.

MR. BALTO: You know, it's hard for me to comment on the terrific presentations of these two speakers. You know, generic -- let me make a simple point. Generic drug companies are almost never dominant. We're in like the most intensely competitive market. In any generic drug category you're certainly going to have five, six, seven competitors. Prices quickly computed down to marginal costs. So the headaches my colleagues have to live with I don't really have to deal with.

I do have a little concern about one suggestion that Ron made, however. The idea that we should have a safe harbor for customer-instigated exclusive dealing. I just know from my experience in the enforcement agencies, you know, you'd always walk in there, and oh, you would have anticompetitive conduct investigations. And the parties would say, oh, customers really wanted this.

Well, you know, when you actually sat down and were able to go and interview the customers you found out that, you know, they wanted it only because their arm was being twisted in a significant fashion.

And also sometimes the interests of customers aren't really in confluence with the interests of consumers. And I think one of the kinds of practices that a lot of the previous speakers at these hearings have identified, some of the kinds of practices they've identified are situations where basically a dominant firm agrees to share its monopoly profits with its customers in order to keep rivals at bay. And you know, believe me, the customers like those situations, but I think those situations still can be harmful to consumers.

MR. TARONJI: Patrick.

MR. SHELLER: Really the only comment I'd like to make is one of gratitude to Ron. I suggested a number of problems that we at Kodak are facing because of some of the ambiguities in the law relative to bundling and also the law relative to aftermarkets. And I thought Ron made some very viable suggestions that could help maybe clear up some of those ambiguities. So thank you, Ron.

MR. TARONJI: Ron, your turn.

MR. STERN: Well, thank you, Patrick. Let me comment just briefly on David's presentation. I'm not particularly familiar with the pharmaceutical area, although as an antitrust lawyer these days you have to end up having some familiarity because there's so much activity in the pharmaceutical area.

It just struck me that it was a situation in which perhaps it called out for regulatory reform to address many of the issues that David was talking about rather than having the antitrust laws and the court bear the entire burden in this area.

It is one in which, of course, there are large expenditures made and large amounts of money at risk when the patent protections go off. And obviously that causes people to look for opportunities to continue to make the profits during the protected time period. And again, regulatory reforms may be a better solution.

With respect to his sham petitioning point, it seems to me again this is an area simply in which clear rules would be important. I don't think anyone would deny the importance of First Amendment petitioning or the basic soundness of the Noerr-Pennington Doctrine.

So if there is going to be greater emphasis placed on some sort of exception to that exemption, then it seems to me it needs to be a clear one so that people can counsel and take advantage of the governmental processes and the First Amendment in an appropriate way and keep one's clients out of a situation in which they expose themselves to government investigations and treble damages lawsuits.

And to his other point, if I could take a moment on the customer-driven or customer-initiated exclusives, I take his point that there can be seller-initiated customer demand, and that's a fact issue. But it's sometimes very clear if a customer puts out an RFP and there haven't been any private discussions, that it's customer initiated and that's the way this will happen, I believe in a number of contexts. And if in fact you can -- you know, a seller tries to undermine the process by promoting or encouraging or incentivizing the customer to make such a request, you know, I think that can be addressed and dealt with.

MR. TARONJI: I'm going to start off with some general questions, then we'll move to some of the conduct-specific questions that we talked about. And I'd like to talk about counseling.

As a person who has given antitrust advice on the type of business conduct your company can or cannot engage in, have you found that there are specific types of conduct where the state of jurisprudence is such that your legal advice is either one, particularly easy to give and apply; or two, particularly difficult to give and apply? Let me start with you Ron, and then I'll go with Patrick.

MR. STERN: Great. I'll be brief because that's mostly what I talked about.

It seems to me in the U.S. it's not difficult to apply the monopoly power threshold element these days. At least I haven't found it inordinately difficult. In tying, it's pretty easy to counsel as to when you are or are not engaged in tying. You have some other issues, if you are engaged in tying, to evaluate whether the conduct is exclusionary or not. And as I mentioned in predatory pricing, I think there's some pretty clear guidance.

The difficult areas are the ones I mentioned regarding bundled discounts, refusals to deal, and the thorny problem of aftermarkets. So that would be my list.

MR. TARONJI: Okay. Patrick.

MR. SHELLER: I would echo what Ron said. You know, we don't seem to have too much difficulty indentifying the market monopoly power threshold, in the U.S. anyways. That becomes more of a challenge when we counsel clients outside the U.S.

Tying, as I said in my remarks, used to be an easier area in which to advise. But now, as I said, I think the line between tying and bundling is blurred because of the LePage's case. So today we have a have a lesser degree of confidence in couseling on tying arrangements.

Exclusive dealing, predatory pricing, I think the standards in those areas are fairly well established by the courts and by the agencies.

The other area where we find challenges under Section 2 are the catch-all "other exclusionary" practices where you can have problems. There are cases like Conwood where the conduct was so egregious that you don't have too much trouble advising the client not to, e.g. tear down a competitor's store displays.

But what other sorts of aggressive marketplace conduct that doesn't fall into the categories that we've just listed could offend Section 2? I think in many of these areas the law is either undeveloped or not developed to the extent where you can confidently advise. I mean, for example, how do you advise a client that has a relatively high market share with regard to how many of its competitor's employees they could hire? And that's an issue that has been litigated to some extent, but I think the lines are very unclear in that area.

MR. TARONJI: Okay. Great. And David, feel free to jump in whenever you want to.

How do businesses such as yours respond to variations among different countries' competition laws with regard to single-firm conduct? Specifically, do international businesses decentralize decision making on business conduct to adapt to a foreign jurisdiction's competition laws?

Patrick, from Kodak's standpoint as a chief compliance officer and ensuring that Kodak is complying with all laws in all jurisdictions where you operate, how do you make those decisions where the standards may very well be different from one jurisdiction to the next?

MR. SHELLER: Well, we're definitely in the decentralized model. We have in-house counsel in most of the major markets around the world. So we rely very heavily on their advice.

However, there are circumstances where a business client may at the worldwide level be considering a program that, at least based on our limited knowledge of the standards overseas, might pose problems, although they wouldn't in the U.S.

So we do have a bit of centralized thinking in the international area. I was fortunate enough to have spent four years in Europe working as an in-house lawyer for Kodak, so I was able to pick up some of the thinking in competition law area. And I have a pretty good sense of what might offend the European Commission laws. But beyond that, we really, as I said, do rely on our oversees colleagues.

MR. TARONJI: And Ron, I assume General Electric is organized much along the same lines?

MR. STERN: Well, General Electric is decentralized. As people know, there are multiple General Electric businesses, each with their own CEO and own legal department. But there is sort of global assistance in the competition area, which is sort of what I and a small group of my colleagues do.

And I would say that this question is a good one, and for G.E. it varies. There are a number of businesses we're in that are truly global businesses where you really need to counsel on a global basis rather than individualize.

The customers may be in different jurisdictions, but it's probably a global market, and you really can't go through the time and effort to try to figure out about extra-territorial application of the various laws.

So you try to counsel to sort of an international standard, always I think being concerned about the U.S. being necessary, because of the unique treble damage exposure and litigation costs in the U.S. But not sufficient, because you really want to make sure that you're meeting any more restrictive requirements in other areas.

If we had it, which we do, businesses that operate much more locally, and their conduct clearly is only going to affect a particular jurisdiction, you can be confident of that, then you can get more localized advice about the actions that will just affect that jurisdiction with a key caveat, and I think this is important for everyone to recognize. Certainly, General Electric, and I expect many companies' business executives and even mid-tier employees move from country to country. Organizations change so that an organization that used to operate only in countries A and B the next day operates in countries A, B, C, and D. You don't have time when you're counseling to readjust everyone's headset when you don't know when they move.

So I think it's quite important in fact to avoid issues and to sensitize people to counsel to a norm because it's simply not efficient and it's dangerous in the long run to try to sort of say there's no competition law in country X or no enforcement, and so we can do as we please, even though we know in a neighboring jurisdiction where generally that conduct is likely to provoke investigations or litigation.

MR. TARONJI: In looking at whether you can come up with a uniform standard for counseling purposes, do you try to determine what is the most restrictive provision out there and counsel toward that, or do you go back and again look at the specific situation and look at it country to country and advise accordingly?

MR. STERN: I think in general you do both. You try to make sure that you come up with something that's simple. The idea of clear and understandable rules is important because you have to be able to give clear and understandable advice. If you're giving advice that's too complicated to business people, you have to realize that there's a large risk that the execution will not be in conformity with the advice. And if that's a problem, then you've created a problem for the client.

So it seems to me that in these sorts of situations, you really are looking for some sort of uniform standard. And if in fact there is a more restrictive approach taken by an important jurisdiction, one that is likely to have either private enforcement or government enforcement, even by way of investigation, then you try to find a way in which you're going to be in some sort of comfortable, clear, safe harbor zone. And only if that creates real problems with achieving what you think is a legitimate business objective, are you able to spend the extra time and effort to see if you can design something that's more complicated.

So I think the concern that I was trying to express about the need to address this globally is that U.S. legal clarity at least in a number of areas, could be overridden by a lack of clarity or by overly restrictive rules outside the U.S. and the harm could come to U.S. consumers as well as those in other areas.

MR. MATELIS: Do you have anything to add, Patrick?

MR. SHELLER: We also take a slightly different approach which is to start with analyzing proposed plans under the U.S. standard. And assuming that we can give the green light from a U.S. antitrust perspective, then the next step would would be to look at whether there are nuances under European law that might create a problem. Then we'd seek advice from our European counsel on those particular aspects.

And you know, increasingly now we'll look at some of the bigger markets and their antitrust enforcement. Ron spoke a little bit about the anti-monopoly law in China. We'll be keeping a close eye on developments there. And as that unfolds, it will be an important area that we'll focus on in our antitrust counseling.

But as the starting point, we typically begin with the U.S. standards.

MR. MATELIS: I have a question about clear rules. Ron and Patrick, in your remarks you both stressed the virtues, from your perspective, of clear rules in the Section 2 context.

David, in your remarks you sounded a provocative cautionary note that maybe clear rules have some drawbacks. And I'd just like to get all of your perspectives again on a very basic question. What are the pros and cons that policy makers and courts should be thinking about when articulating rules? Maybe we could start with you, David.

MR. BALTO: I actually was interested in Ron's presentation. I thought the questions he posed were really good ones. But I sat there looking at the issues that Ron was posing and I said, now, what exactly is the rule in some of these situations that Ron wants that's going to make his life so much easier in counseling people?

And I think that to the extent that it's a rule that's going to make Ron's life simple, Ron's life -- you know, Ron will be able to sleep at night because he knows he can give a clear message to the business person, and the business person can follow it in a relatively straightforward fashion, you know, I'm not sure that that's really going to happen. In many of these situations, I think that if there is -- there is potential for anticompetitive conduct.

You know, you can look at the full range of things that Microsoft did that the Justice Department properly attacked in their lawsuit against them. And if you looked at them in segregation, you might be able to determine that there would be a clear rule that would suggest this kind of conduct might seem to be legal. But if you put all of the types of conduct together, you could see why the conduct was really problematic.

So I'm a little hesitant about clear rules. And for my perspective, I mean the clear rule, everybody in the world -- you read the hearing transcripts for these hearings, the clear rule everybody loves is Brooke Group and predatory pricing.

And one of the most important points I want to make is in industries such as pharmaceuticals, going and talking about whether something is below your variable cost is a meaningless concept because all the costs are up front. So I don't think that rule -- that rule bears too great a risk of under-enforcement, which ultimately will harm consumers.

MR. SHELLER: Well, as I indicated in my remarks, we would certainly favor clear rules in the Section 2 area for a couple reasons. One is that it does make the in-house counsel's job easier. They can draw brighter lines for the client.

Second, I think it's important because it helps to make the antitrust laws appear more serious to business clients. If a business client is told that there's no real clear legal standard in the area where you're proposing a particular marketing plan, but here's some of the factors that we might consider, their reaction is likely to be: we might as well take the risk then. And so I think setting out clear rules helps business people to follow the antitrust laws.

I would, however, note a caution that safe harbors in the form of guidelines can be can be helpful, but they can also in some ways be unhelpful. And I'll give as an example the European block exemption on technology transfers and some of the safe harbors that are built into that exemption relating to market share. The market share thresholds that the Commission uses are very low so that almost any transaction you would consider in the IP area is going to be outside of the thresholds. It's not helpful to set a threshold that low. It's too conservative.

The Commission does provide some other factors and guidelines that companies should consider. But I think it sort of undermines the benefit of providing guidelines when you set thresholds that are too low.

MR. STERN: Just comment briefly. I do think clear rules are important. I don't think there's a one size fits all rule, to respond to a point I think David made. I don't think it's a situation in which you need to have one principle that you use across all of the types of exclusionary conduct in Section 2.

I think it is important obviously that the clear rules also be thoughtful, or they can do more harm than good. And I think what you're really looking for are principles that you can apply, understand, counsel to, and have some sort of confidence that the business can execute to them and that the courts and the enforcement agencies can predict -- you can predict how they're going to apply them. And that's really what I think we're searching for.

And I think as my talk indicated, I'm happy to have them addressed in little half steps that do things that seem perhaps unimportant to some but are important in the real world. I think those steps are important and should be taken and not taken for granted.

And secondly, I agree very much with Patrick's point. People need to look at guidance that's meaningful. Safe harbors that do nothing to clarify the situation because they only exist in situations in which you never anywhere have monopoly power are useless. It doesn't really help you. But meaningful safe harbors and ones that are understood not to define the line between legal and illegal, but to simply define and clarify what is clearly legal and not questionable are very important.

MR. COHEN: Let me just return to David because you've for a second time referred to your thought that relying on average variable cost just doesn't work in the pharmaceutical industry as a test of predation. Do you have an alternative to that? And would any of these alternatives guide a firm with a large market share in determining what conduct it can engage in that increases its revenues in ways that have nothing to do with excluding competitors?

MR. BALTO: Well, I think the answer to the second part of your question is no. I'm more concerned about possibly -- about our properly identifying anticompetitive conduct and stopping it. And the counseling question I'm going to sort of leave to the side.

I look forward -- as to the first question, are there other standards, I look forward to the presentation that the representative of American Airlines is going to bring about the Justice Department case this afternoon.

I think some of that same problem of high fixed costs, low variable costs were grappled with by the Justice Department in that case. I think because of that there is increasingly interesting economic literature that uses -- that talks about the use of predation, the use of above-cost price -- of certain pricing strategies to create a reputation for predation and how that kind of predation can be anticompetitive. And you know, I think that's something that I know the courts and the agencies need to explore further.

MR. STERN: Can I just comment just for a second?

MR. TARONJI: Go ahead.

MR. STERN: I'm sure the economists who have participated in these hearings or will participate in later hearings or comment at the two hearings will know much better than I do.

But it seems to me at least it's a bit simple to say because variable costs are low and fixed costs are high that that standard doesn't work. It seems to me in that context what it really means is that there's very little likelihood of exit because people are committed in the market and they've sunk their costs. And in that situation it's not clear how you end up with recoupment or whether you really have a problem.

And I don't purport to have the answer, but it seems to me it's a bit too facile to simply suggest that because average variable costs are low that the standard shouldn't be used.

MR. BALTO: Let me just mention an area that I've written on and that the FTC is currently studying. That's the issue of authorized generics, which I deliberately kept out of my testimony because there's a fair amount written about this.

An authorized generic is an arrangement between a branded pharmaceutical company that they enter into with another generic company to promote the entry of a second generic just prior to or immediately with the entry of the legitimate generic company. In other words, it's mother one of those situations where the generic is placed into the market it plans to -- you know, it plans to enter. And under the FDA regulations there's is six-month period of exclusivity, which is the vast majority of the profits that a generic company makes when it enters into a generic market. And I've written about how this sort of strategy of, you know, making a deal with still another generic company to enter at the time of the legitimate generic's entry can be a strategy of predation. All the pricing is above cost. I think the pricing is meaningless.

But what's important about it is that what you're doing there is sending a signal to the generic firm that it's -- you know, if you plan to enter my market, you can expect the rug to be pulled out from under you, and you're not going to get the reward you're expecting to get.

And I think it's much more interesting to look at it from a certain strategic perspective.

MR. TARONJI: As you know, antitrust lawyers and judges are battling over how much weight to give to business documents, from strategic plans to e-mails and sales and marketing personnel.

What consideration should

antitrust enforcers and courts give to intent documents in assessing a firm's conduct?

MR. SHELLER: I'll start out with that. My view is that business intent documents have a role in attempted monopolization cases, and that is primarily it. There are ways in which you might use business documents in monopolization cases. But I think they need to be considered in terms of who wrote them.

Often plaintiffs' lawyers, and to some extent the agencies, will rely on a bad document that might have been written by someone at a lower level in the organization. And it's really a statement of opinion.

Obviously it's not something we as in-house antitrust counsel want to see from our clients. And we advise them not to write in that sort of manner. But you have to ask the question whether those views that are stated by a sales representative or a sales manager represent the views of the company.

On the other hand, if you

have clear statements being issued in internal documents by a corporate officer, for example, or the head of a business, then obviously that document ought to be given more weight and might be of more value in a Section 2 case. But again, I think documents play the most important role in attempt cases.

MR. STERN: And I'd just add very quickly that it seems to me that objective standards are better than subjective ones. It's too easy in a large organization to find the snippet in a document and try to make that mean something more than it does, not in context.

And what the law wants people to do in business is to compete aggressively and attempt to win in the marketplace. And that can be expressed in a way certainly if a lawyer writes it so that everyone would think it doesn't pose an intent problem. And that same kind of intent or motivation can be expressed in a way that someone might make more out of it than I think they should.

MR. COHEN: Would your suggestion to look at, in the exclusive dealing context, whether the policy is customer driven or driven by other internal motives take you into the area of looking at intent documents?

MR. STERN: I don't think so. I think they might get you into the area that David talked about of seeing who actually initiated it. If the customer put out the RFP that I mentioned seeking a bid for all of their demand for three years, if in fact there were documents that showed that this was the initial idea and that they were essentially compensated for deciding to do that by the lead provider in the marketplace, that's, I think, the kind of situation David was talking about. And I don't think that's an intent issue. It's really: Was this the customer's initiated approach or was this essentially a supplier- initiated approach? It doesn't have to do with whether the intent for the exclusive was pro-competitive or anticompetitive.

But it does, to be clear and sort of to finish the thought, the general notion is that a customer will not go out and seek, you know, this kind of winner-take-all situation unless the customer thinks it's going to benefit by it.

In general, since the law is trying to promote customer welfare, the customer presumably would think it had enough competition and that by putting its demand out to this kind of winner-take-all bid that it wasn't changing the structure of the marketplace to its long-term detriment.

MR. TARONJI: Well, I want to make sure that with the remaining time we have the opportunity to cover some of the substantive conduct issues. And let me go to bundle discounts.

Does market share provide a useful screening mechanism for assessing loyalty discounts? And then I've got some subsets, so let me ask all of them and then you can comment on all of them.

Could we state a useful safe harbor based on market share; and if so, what should that share be?

MR. SHELLER: Let me address the question on loyalty discounts, which I distinguish from bundling in some respects. I think loyalty discounts can be an issue under Section 2 if they're really equivalent to exclusive dealing. If a customer is given a significant discount if they buy 100 percent of their needs from the dominant supplier, then I would agree with the view that the European Commission takes: that this is tantamount to an exclusive dealing arrangement.

Therefore, market share thresholds could be important. 100 percent exclusivity is obviously a good indication that you've got exclusive dealing. Whereas, if the supplier through a loyalty discount tied up say 70 percent of the market or 60 percent of the market, then you're less likely to have competitive harm. There would still be opportunities for rivals to place their products with that particular customer as well as other customers.

MR. STERN: I guess my

reaction is that the term loyalty discounts encompasses so many different kinds of pricing practices and so many different situations that I would be hesitant to provide one market share test to address it. You know, just -- Patrick had mentioned the European Commission. In their Article 82 discussion paper they, I think, appropriately draw a distinction between a situation in which the different competitors, the suppliers can essentially compete to supply the entire demand of the customer or the entire demand in the marketplace versus a situation in which, I think as they express it, the customer must carry a certain percentage of the leading firm's products. That's more of a distribution kind of a situation. Those two are sort of night and day different. And you would think in a loyalty discount situation, you would want to be treating them very differently.

To Patrick's point, you know, are they equivalent of exclusive dealing, or are they essentially just competing for the opportunity and competing aggressively and above cost, in which case the loyalty discount wouldn't be a problem.

For these hearings, I went back and read some cases I'd read before the Concord Boat case. And in that situation it seemed important to the Court, and I think validly so, that a number of customers had decided that they could switch all of their demand away from Brunswick, who was the leading engine supplier, to their rivals depending on what kind of deal they got. In that kind of situation, you know, having a loyalty or a market-share-based discount was just one way of competing, which is what the Court determined, and it was above cost. So that would be my long-winded answer which is it depends.

MR. TARONJI: David, in your presentation you suggested that the generic pharmaceutical industry is different, and so the standards, rules, guidance should take into effect that the pharmaceutical industry is different. How should the enforcement agencies take that into account?

MR. BALTO: Well, you know, it's interesting if we really got into a long discussion of these -- you know, these different types of arrangements like tying, bundling, loyalty discounts, so on, some of the key cases involved pharmaceuticals and medical devices. Smith Klein versus Eli Lilly which involves, you know, a special pricing program to sort of compel people to purchase three drugs instead of two drugs. Ortho versus Abbott, which involves, you know, sort of market share discounts and so on and so forth.

I think -- I'm not sure that in this area the rules need to be that different. I think it's just it's easier in this setting involving pharmaceuticals to identify the existence of an inelastic class of customers. And you know, most of the literature in this area suggests that it's necessary to have some set of inelastic customers.

But I'm still waiting for Patrick and Ron to give me the market share threshold that makes it a safe harbor.

MR. STERN: Well, I go back to the comments I made in my presentation. Oftentimes, if we are really talking about what is the market share of the party that's engaged in the conduct, you can go back to the monopoly power test and those thresholds and to the attempt threshold and the other aspects, as opposed though if we're asking at what level of market share can you set a market share-based discount. That, I think, is hard to say if you don't know what the context of the particular market is.

MR. BALTO: Can I pose a question for Patrick then? One thing I think is really interesting when you look at jurisprudence in this area is that the courts use this very hard threshold on Section 1 cases, you know, when it looks at bundling or market share discounts. And you know, you look at the lower court's decision in Microsoft.

But when it comes to Section 2 they become more touchy feely and seem to be willing to project the potential for competitive problems even at lower market shares. And that's basically what happens in

Densply and Microsoft and in LePage's.

You know, from a business's perspective, how do you sort of look at that?

MR. STERN: Well, I'll step up to that one. It seems to me it was the comment I was trying to make when I was asking some questions about 3M LePage's.

I think the most difficult area to counsel in, just because I think the law isn't very clear and helpful, and the jury instructions aren't very helpful is a situation in which you are clearly in a category where you have monopoly power. You meet that threshold. You're taking conduct that either involves exclusive dealing or some other type of conduct that the law can characterize as being exclusionary, and then the question, as I think I mentioned is, well, what sort of impact does that have to have?

And I think in the Section 2 context your comment is correct. We don't have as much guidance. There is some notion that -- which I think shouldn't be the case, that if you're a leading firm, you have to act differently in some sort of way. That notion is reflected in the European community law with respect to some special responsibility, and some of the older case law affirms they're deemed to be dominant.

I think in this situation, one of the areas that the hearings could benefit everyone is grappling with the issue, particularly in the area of pricing, which I think everyone is focused on of guidance and rules that make sense for firms that are leading firms, that you want to compete aggressively in the marketplaces in which they are leading firms because that is overall beneficial. But if in fact anything that might be characterized as too aggressive or characterized as exclusionary can be subjected to treble damages and a big monopolization investigation, all you're going to do is get people to pull their punches to the ultimate harm of consumers and competition.

I think it's the same problem as I tried to illustrate with rules that turn on whether you've started to deal with someone or not, because they give you perverse incentives at the end of the day.

MR. SHELLER: I think the market share test has limited value. I mean, it's a good starting point in which to advise clients. But what I tend to look at more often are other factors like whether this particular business has the ability to control prices in the market.

I'm thinking about a specific example of a business that I've advised at Kodak which is considered to have a high market share for a particular segment. But I know from experience in working with the business, that if they were to raise their prices by five percent, we'd see an influx of customers turning to competing suppliers. So in that sense I don't think the market share that's attributed to that business is a valuable indicator of market power.

And the other thing is the point that I made in my remarks which is that although you may have businesses in

Kodak's world which are beginning to lose share to other technologies, you've got to take those technologies into consideration in determining whether you've got a Section 2 case or not and whether those technologies ought to be included in the market.

MR. STERN: And just to add to Patrick's point, because I think it does a good job of illustrating one of the earlier questions about clear rules. I think it's -- the clear rule about the ability to control market prices, that may not sound as clear, but I think antitrust lawyers and clients can work off of that kind of rule versus one that had some hard and fast market share threshold as if that were a clear rule.

First, I think it's not a thoughtful one, as I mentioned, to have a hard and fast market share threshold. And secondly, it gives, I think, a false sense of clarity because it's all, of course, how you define the market and how you define the shares.

Having a clear principle

about one's ability to control market prices, it seems to me, is one you can apply in a market context and give -- be fairly comfortable about giving advice. And that's why I think it's important in the global context that people move more towards this kind of behavioral approach rather than a structural approach.

MR. TARONJI: Let me end on one question dealing with misleading and deceptive conduct.

Do you agree that if tortious conduct can be the subject of other causes of action or regulated under other regimes such as Food and Drug Administration, it should also be the subject of antitrust causes of action? I figured David had a strong feeling about that one.

MR. BALTO: Yeah, absolutely. If something independently violates the antitrust laws, that's fine. We should realize that -- I appreciate Ron's comments about my testimony. The regulatory process moves -- that these may be regulatory problems. The regulatory process moves slowly and amending it is very difficult.

Antitrust enforcement plays a vital role in sort of telling people where there are problem areas. And part of -- you know, what I'd like to do is show you -- you know, part of what we do is -- what people do as enforcers is raise attention to things.

There's a recent court decision involving the drug DBABP which is used by tens of thousands of consumers, and there was a sham petitioning claim. And the sham petitioning claim was dismissed with seven words. That's all the district court judge said about the sham petitioning claim.

You know, part of this is having enforcement agencies pay attention to these types of issues, I think, affects behavior of the businesses involved and reduces the likelihood that they engage in deceptive and sham conduct.

MR. SHELLER: I would be very reluctant to apply a rule where the alleged predatory conduct, if it meets the standard of some state law violation, ought to be the basis of a Section 2 claim.

One single violation of a state law, let's take tortious interference or theft of a trade secret as examples, does not amount to a Section 2 violation when coupled with monopoly share.

Now, if you had a pattern of conduct occurring with respect to several customers or in several geographic markets, again Conwood being an example, then yes, you could have a Section 2 situation. But I'd be very reluctant to endorse the notion that a single violation of state law can be the predicate act for a Section 2 case.

MR. TARONJI: Okay. Any other questions? Great. Well again, I want to thank all of our panelists for their interesting -- I'm sorry.

MR. BALTO: Could I just end with a final comment --

MR. TARONJI: Go ahead.

MR. BALTO: -- because I'm pushy.

I just wanted to talk about

the devices for the agencies as they look at Section 2 enforcement. And I think this is a point that all three of us would agree on.

The role of the agencies in filing amicus briefs, not just before the Supreme Court, but in lower courts, in district court cases is tremendously important. The reason why millions of consumers now can buy generic Buspar is because the Agency, the FTC filed a brief before the district court judge explaining by the sham conduct that Bristol-Myers was engaging in was not immune under the Noerr-Pennington Doctorine. They went down to the district court.

I think those types of cases are tremendously important. There are tons of headaches that these people have in trying to interpret LePage's. You should go look at what's going on in the district courts. LePage's type cases are currently being litigated. And look for opportunities to provide clarity in that setting so that when the district court judges reach decisions on these difficult LePage cases they're informed by sound economic and legal principles.

MR. TARONJI: Any of you want to have a final word?

MR. SHELLER: I would like to endorse David's remarks and just add the following. The agencies, and I'm going to again focus on the two areas of concern for Kodak -- the bundling area and the intellectual property rights -- had an opportunity to urge the Supreme Court to take up a case and really settle the law in that area, LePage's and then the Xerox case. In both cases the agencies took the view that maybe those issues weren't yet ripe for the Supreme Court to consider.

I would suggest that you be very clear in your advice to the Supreme Court in the future when the time is right to take those issues up. We would certainly appreciate that. And it would provide a lot of helpful guidance to the business community.

MR. TARONJI: Great. Ron, any final comments?

MR. STERN: Nothing other than to thank you and the few hardy souls who actually made it today for joining us.

MR. TARONJI: Please join me in a round of applause for our panelists.

(Applause)

MR. TARONJI: And we will reconvene at 1:30 for our second panel.

(At 12:00 noon a luncheon recess was taken until 1:30 p.m.)

AFTERNOON SESSION

MS. GRIMM: Good afternoon. I am Karen Grimm, Assistant General Counsel for Policy Studies at the Federal Trade Commission. I'm one of the moderators for this afternoon's session. My co-moderator today is Joe Matelis from the Antitrust Division of the U.S. Department of Justice.

Before we start, let me cover just two preliminary housekeeping matters. First of all, as a courtesy to our speakers, we'd like for you to turn off your cell phones, Blackberries, and any other devices. And secondly, we ask that the audience not ask questions or make comments during the hearing. Thank you.

Before introducing our speakers this afternoon, I would like to first thank the University of Chicago's Graduate School of Business for hosting these joint FTC/DOJ hearings to solicit testimony on single-firm conduct. In particular, I would like to thank Dean Ted Snyder and the staff of the Gleacher Center for offering us their facilities and for making the necessary arrangements for us to hold these hearings here.

And finally, I would like to thank my FTC and Justice Department colleagues as well as the FTC's Midwest regional office in Chicago who have worked very hard to put these hearings together.

We are honored this afternoon to have a distinguished group of panelists from the business community. Our panelists this afternoon are first Sean Heather from the U.S. Chamber of Commerce, Bruce Sewell from Intel Corporation, and Bruce Wark from American Airlines. Sean, I will note, is standing in at the last moment for Stan Anderson who was unable to be with us.

Our format this afternoon will be as follows. Each speaker will make a 20- to 25-minute presentation. We will then take a 15-minute break. And after the break we will reconvene and have a moderated discussion with our panelists.

As Jim said at our morning session, these hearings in Chicago are an extremely important component of the joint FTC and Antitrust Division hearings on single-firm conduct under Section 2.

Over the past eight months we have held hearings in Washington D.C. primarily focused on specific types of business conduct such as predatory pricing, refusal to deal, bundled and loyalty discounts, tying arrangements, exclusive dealing, and various types of misleading and deceptive conduct which have been challenged under Section 2.

While some of these earlier panels have included business executives and their legal advisers, they have for the most part focused on specific types of conduct and have relied most heavily on speakers from academia and the private bar.

Our sessions today are somewhat different. They are designed to provide a forum for businesses to tell us what particular Section 2 issues are of concern to them, and to suggest ways in which we at the FTC and the Antitrust Division may be better able to address those issues and provide additional guidance on their particular areas of concern.

Our panelists today have accepted our invitation to share with us their perspectives and views on Section 2 issues and enforcement. I want to thank them all for agreeing to participate in today's hearing and look forward very much to hearing what insights they have to share with us.

I would now like to turn over the podium to my colleague and co-moderator, Joe Matelis, from the Antitrust Division for any remarks he would like to make. Joe.

MR. MATELIS: Thanks Karen,

and because my remarks will be brief, I'll do them sitting down.

The Department of Justice's Antitrust Division is very pleased to take part in today's session, and I'd like to reiterate what Karen said, that we're interested in hearing about the perspectives of businesses. And so we're looking forward to your remarks today. And also repeating Karen, on behalf of the Antitrust Division, I would like to thank Bruce, Bruce, and Sean for coming here and agreeing to share your time and thoughts with us. We know that a lot of effort and work goes into these presentations, so we're extremely grateful for you for rendering this valuable public service, and particularly in February in Chicago.

I would also like to thank on behalf of the Antitrust Division the Gleacher Center and the University of Chicago Graduate School of Business for hosting these hearings. And finally, I'd like to thank Karen and her colleagues at the FTC for organizing today's wonderful session.

Thanks.

MS. GRIMM: Our first speaker this afternoon is Sean Heather. Sean is with the U.S. Chamber of Commerce. He serves as its executive director for global regulatory cooperation. Global regulatory cooperation is a new program at the Chamber focused on regulatory divergence around the globe and its impact on international trade.

Prior to leading this project at the Chamber, Sean worked for nearly eight years in the Chamber's formulation and lobbying shops. He has his MBA and undergraduate degrees from the University of Illinois. Sean.

MR. HEATHER: Thank you for the opportunity to appear before you today to address the important issue of whether and when specific types of single-firm conduct may violate antitrust law. I will summarize my written remarks, which the Chamber has separately submitted. I would ask that both be included as part of the record.

I appear today on behalf of the U.S. Chamber of Commerce, the world's largest business federation, representing more than 3 million businesses of every size, sector, and region.

The Commission and the Department should be congratulated for holding these hearings and reaching out to the business community for its views on this critical topic.

At the Chamber, we work continuously to promote free market principles, because we see the free market system as essential to ensuring a vibrant and productive economy. And we believe that balanced and effective antitrust enforcement is critical to ensuring a free market.

In the U.S. we support the application of Section 2 of the Sherman Act to conduct that threatens competition and harms consumers. And outside the U.S., we support the application of similar laws.

However, the Chamber believes that the U.S. and foreign competition authorities must use special care in policing single-firm conduct to avoid chilling behavior that is in fact both procompetitive and beneficial to consumers.

To accomplish this, we believe antitrust rules must be 1) transparent, 2) predictable, 3) consistent across jurisdictions, and 4), reasonably stable over time.

It is important to remember that new products and new business practices are developed well ahead of their actual introduction and ahead of any scrutiny by antitrust regulators. Firms do want to obey the rules of the road, but discerning and applying those rules is becoming increasingly difficult. In its September 5th written submission to these hearings, the Chamber focused on the need for clear, predictable standards for tying and essential facilities analysis to domestic enforcement of Section 2. Today I'd like to extend these principles to international antitrust enforcement and highlight the importance of cooperation among antitrust enforcement officials around the world.

The U.S. Chamber of Commerce has recently announced a major new initiative, the Global Regulatory Cooperation Project. This project aims to increase awareness about and to develop successful strategies for combating the growing threat that divergent regulatory systems pose to competitive markets and to international trade.

The need for Global Regulatory Cooperation is clear. Barriers to international trade go beyond market access issues. Traditionally, trade agreements and negotiations have focused largely on tariff reductions. While market access must remain a priority, divergent regulations are increasingly impeding trade, and governments around the world need to better understand the impact in-country barriers have.

While the Chamber's project focuses on many types of divergent regulations, one area that deserves special consideration is competition policy. I'd like to make the following three points.

First, the growing proliferation of antitrust enforcement around the world, together with the globalization of business creates increasing risk of conflict in the application of antitrust rules to single-firm conduct. These conflicts impose costs on firms and harm consumers and are becoming potential barriers to international trade.

Second, while many differences may be discerned between U.S. and foreign standards for single-firm conduct, the differences in the enforcement approach on tying and essential facilities analysis is becoming increasingly apparent.

Third, now is the time to act on these differences. The U.S. must lead a cooperative effort among industrialized nations to develop and recommend appropriate standards for single-firm conduct and to promote their adoption around the world.

Over the past 15 years, the number of jurisdictions with antitrust laws has grown from about 25 to approximately 100 today. Many of the newer enforcement agencies have limited training, experience, and resources to police anticompetitive behavior and enforce their laws appropriately.

One thing is certain, the impact of competition decisions by any given enforcement agency no longer is confined by its home jurisdiction. Increasingly, those decisions reverberate around the world, forcing firms to conform their behavior to the most restrictive enforcement policies and increasingly have a negative impact on the global marketplace.

The underlying goals of antitrust enforcement and trade liberalization are similar in that both aim to achieve open and competitive markets. In their application, however, competition laws may sometimes constitute barriers to trade. In some countries, particular enforcement actions may be motivated by protectionist goals. In other instances, differences in general legal standards or in remedies may have a chilling effect on trade.

In her statement opening these hearings, Chairman Majoras remarked that quote: "Disagreement among competition authorities about how to treat unilateral conduct produces uncertainty in national and world markets, reducing market efficiency and imposing costs on consumers."

Other government officials, both in the Executive Branch and in Congress, as well as many business and Bar Association groups have also joined in recognizing the growing potential for conflict and the costs and burdens associated with it.

The record clearly demonstrates that these costs are very real. For example, Microsoft has been subject to three different sets of remedies in three different jurisdictions for what is essentially similar conduct.

In March 2004, the European Commission held that Microsoft had abused a dominant position in violation of Article 82 of the EC Treaty by tying the purchase of Windows Media Player to the purchase of the Windows operating system and by refusing to share proprietary communication protocols with competitors and allow their use in developing operating systems that would compete with Microsoft's own products.

When the EC issued its decision, then-Assistant Attorney General Pate issued a statement criticizing it as both costly and unnecessary in light of the final judgment entered against Microsoft by the U.S. in 2001.

Later Pate expressed quote "deep concern about the apparent basis for this decision and the serious potential divergence it represents." Noting that "It is unfortunate that considerations of international comity and deference did not, in the Commission's judgment, carry sufficient weight to avoid the significant divergence that has now occurred."

Soon after the EC's decision, the Korea Fair Trade Commission held that Microsoft had abused a dominant position in South Korea by integrating media and instant messaging software into Windows and posing a code removal remedy similar to the one imposed in Europe. On that day the decision was announced, Deputy Attorney General McDonald released a statement stating that quote: "The Antitrust Division believes that

Korea's remedy goes beyond what is necessary or appropriate to protect consumers."

More recently, allegations of illegal tying have been the focus of attack on Apple in Europe. Apple uses Fairplay Digital Rights Management technology to encode songs from its iTunes music online store. As a result, the songs may only be downloaded using Apple iPod devices. Norway's Consumer Ombudsman has found that Apple's DRM policies have effectively tied the purchase of iPods to the purchase of its online music, and has ordered Apple to either license its Fairplay technology to competing producers of music players or to develop a new open standard with those companies.

According to press reports, authorities in Sweden and Denmark may follow suit in formally charging Apple with violation of local laws. And the French Parliament has enacted legislation that may require music downloads to operate across a range of devices, empowering a government body to force digital providers to share the information as needed to ensure such interoperability.

Significantly, while the EC has launched an investigation into Apple's music pricing policies, the EC investigation reportedly does not focus on this purported tie.

Apple's success has come about as a result of innovation. Consumers voted with their wallets to reward Apple for its ability to innovate and to commercialize its ideas. Competition authorities should recognize the right of innovators to reap the rewards of their innovation. That is to protect competition, not competitors.

Assistant Attorney General Tom Barnett made this point recently in criticizing the attack on Apple pointing out also that quote: "If the government is too willing to step in as a regulator, rivals will devote their resources to legal challenges rather than business innovation".

In addition to these cases involving Microsoft and Apple where U.S. companies have actually been charged with violations of foreign laws based on legal standards that are arguably divergent with those in the United States, there are several pending investigations of Intel and Qualcomm that may well result in significant conflicts.

Recent press reports indicate that the E.U. might formally charge Intel with abusing its dominance in the market for microprocessors in Europe. According to press accounts, EC investigators potentially believe Intel has interfered improperly with the distribution and purchase of rival products, in part by offering rebates to customers that agree to purchase from Intel exclusively. The Korean Fair Trade Commission is also investigating INTEL's rebate policies.

Qualcomm is also reportedly under investigation by both the Korean and Japanese Fair Trade Commissions, in part for offering lower royalty rates for its CDMA wireless technology if licensees agree to license such technology exclusively from Qualcomm.

The EC has received a formal

complaint about Qualcomm's conduct from a group of Qualcomm competitors, but has yet to actually initiate a formal investigation.

U.S. antitrust enforcement officials are far more cautious than foreign jurisdictions, however, upon investigating and challenging such fidelity rebates and related volume discounts and exclusive dealing practices, because in many cases they may be procompetitive and result in lower prices for consumers. Because Intel and Qualcomm may not be formally charged in these proceedings, it is hard to tell what conflicts with U.S. law may emerge, how severe they may be, and what consequences may result.

As significant as these conflicts among jurisdictions with mature antitrust enforcement regimes may be, they may be eclipsed in the coming years by the conflicts generated by the adoption of new antitrust laws in emerging and transitioning economies.

For example, the current draft of the new anti-monopoly law in China now under consideration contains prohibitions of abuse of dominance that remain unclear, creating fears of an expansive and inconsistent enforcement approach. Ambiguities abound when firms may be considered dominant and when they may be found to have engaged in illegal tying and other abusive conduct are concerns for the chamber. My written statement contains additional details on China's proposed law.

A greater effort must be made amongst the jurisdictions with established antitrust enforcement regimes to improve the content and the consistency of their rules governing single-firm conduct and then share their learning and comparatively greater experience with countries that may be developing new antitrust statutes or modernizing existing ones. Legislative drafters in China and elsewhere will be influenced in a positive way by the development of such a consensus.

In my testimony, I have quoted a number of U.S. officials who have recognized the growing divergence in antitrust standards governing single-firm conduct and what it means for U.S. companies and consumers. But recognizing the problem isn't enough. The U.S. government needs to address this problem with an increased sense of urgency. The Department of Justice and the Federal Trade Commission have devoted resources for many years to fostering cooperation, convergence, and consistency in antitrust enforcement efforts, as well as in remedies.

They have been successful to a degree, but the success has been realized largely in the cartel and merger enforcement areas. Greater priority must be given to the area of unilateral conduct. Today, a handful of companies have been caught up or face the potential of being caught up in divergent interpretations of anticompetitive unilateral conduct.

However, if this divergence in understanding of single-conduct behavior continues amongst the world's competition jurisdictions, more companies globally will be the target of future investigations and proceedings. It is this divergence that the

Chamber's Global Regulatory Cooperation project seeks to counter.

First, the U.S. government must step up its efforts to encourage convergence in substantive antitrust standards for single-firm conduct, and in remedies. To do that, the U.S. must engage more countries bilaterally, and it must work towards greater convergence in the context of such multilateral organizations as the OECD and International Competition Network.

The Chamber believes there is a significant opportunity for the U.S. government to have an impact in this area, given the fact that the FTC co-chairs the ICN's working group on Unilateral Conduct. In this leadership role, the U.S. should be in a position to call attention to diverging standards and work to reduce and eliminate them, particularly in the tying and essential facilities areas, which have proven so important as of late.

Second, the preliminary draft outline of the Antitrust Modernization Commission recommends that the United States should continue to pursue bilateral and multilateral antitrust cooperation and comity agreements with more of its trading partners and make greater use of comity provisions in existing cooperation agreements.

The Chamber believes that the U.S. should explore the concept of enhanced comity, including such elements as an agreement amongst jurisdictions to defer to one another in relation to remedies.

While existing bilateral agreements and the existing application of comity principles have certainly been useful, they have limitations, as illustrated by the inconsistent remedies imposed by the U.S., E.U., and enforcement authorities in the Microsoft matter. Jurisdictions such as these with mature antitrust enforcement regimes should set a coherent and unified example for other countries by expanding their cooperation and making them more consistently successful.

Third, the U.S. enforcement agencies should be encouraged to participate more actively and cooperatively in enforcement and policy development activities with their foreign counterparts, by filing amicus briefs, for example, when U.S. agencies are not conducting parallel investigations.

We applaud this series of hearings for giving your counterparts in Canada, Mexico, Japan, and the European Union the opportunity to testify last September. This kind of cooperative spirit and substantive sharing of ideas is the platform for starting to combat future competition divergence.

Fourth, the need for technical assistance is clear. It is difficult for even the most experienced jurisdictions to define appropriate rules governing single-firm conduct, so newer enforcement agencies may be expected to struggle with them.

U.S. agencies should review the adequacy of current technical assistance programs in the area of antitrust, and implement any changes that may be necessary to make them more effective.

An agency review should include 1), a review of programs sponsored by other countries as well as the U.S.; 2) a review of the work of international organizations such as the OECN and ICN; and 3), a review of the adequacy of U.S. funding levels and how that funding is deployed.

The U.S. must approach this issue holistically and in cooperation with other developed countries to ensure that available resources are allocated efficiently and effectively and to ensure that other important initiatives such as the protection of intellectual property are pursued.

Finally, the FTC and DOJ must approach these issues with a great awareness of the interface between competition policy and international trade, and the impact the divergent antitrust standards have on trade.

To this end, the FTC, Department of Justice, USTR, State and Commerce Departments must coordinate better on these issues. The Department of Treasury should also be involved, as it looks to lead a strategic economic dialogue with China.

And to address protectionist tendencies, agencies across the U.S. government must work cooperatively with their counterparts around the world to ensure that competition policies support liberal trade policies.

This effort is challenging, but critically important. The Chamber stands ready to assist the FTC and DOJ in any way it can, and we look forward to working with you. Thank you.

(Applause)

MS. GRIMM: Thank you, Sean. Our next speaker is Bruce Sewell. Bruce is the senior vice president and general counsel for Intel Corporation. He is responsible for Intel's legal and government affairs functions worldwide.

Prior to being named general counsel, Bruce was Intel's director of litigation. Before joining Intel, Bruce was a litigation partner at Brown & Bane and was an associate at Schnodder, Harrison, Siegel & Lewis.

Bruce received his J.D. degree from the George Washington University and his bachelor's degree from the University of Lancaster in the United Kingdom. Bruce.

MR. SEWELL: Good afternoon. Let me begin by thanking the antitrust enforcement agencies for giving me the opportunity to participate in these very important hearings. I appreciate the considerable effort that has been devoted to these hearings and the dedication that the agencys' staffs have brought to bear on these important issues. I'm confident that the agencys' report will make a significant contribution to the analysis of single-firm conduct.

The development of the law of single-firm conduct is of obvious interest to my company. We are the defendant in a highly visible Section 2 litigation that has generated considerable interest both in the press and among antitrust specialists.

I was somewhat dismayed to see that the plaintiff in our case used these hearings as a forum to rebroadcast allegations that it has made already in its District Court filings and in the press.

With respect to this I will only say the following. Intel prefers to litigate in the courtroom, and I will therefore not use this forum as a -- to argue the merits of our case other than to state that I unequivocally deny the allegations that were made against Intel at the January 30th hearings in Berkeley.

Instead, my remarks today will address the policy issues that have been the focus of these hearings. In particular, I would like to discuss the appropriate role of Section 2 with respect to pricing and discounting practices. I hope that my company's perspective on these policy issues will help to advance the debate that the agencies have generated through these hearings.

At the risk of stating the obvious, the challenge of Section 2 enforcement is to curb anticompetitive single-firm conduct that harms consumers without deterring the type of aggressive competition that benefits consumers through lower prices and greater innovation. This is a great challenge.

As Professors Baumol and Ordover have observed almost 20 years ago, there is a specter that haunts our antitrust institutions. Its threat is that far from serving as the bulwark of competition, these institutions will become the most powerful instrument in the hands of those who wish to subvert it.

Baumol and Ordover stressed the important concept that rules that make vigorous competition dangerous clearly foster protectionism. And they warned of the runner up who hopes to impose legal obstacles on the vigorous efforts of his all-to-successful rival.

These observations were more recently echoed by Professor Preston McAfee and Nicholas Vakkur who catalogued seven strategic abuses of the antitrust laws, including punishing non-cooperative behavior and preventing a successful firm from competing aggressively.

In his presentation at these hearings, Professor McAfee stressed that the antitrust laws can be used to harass, harm, and extort in order to induce cooperation.

The strategic abuse of the antitrust laws is of more than a passing concern to Intel. I was therefore particularly pleased to see both Chairman Majoras and Assistant Attorney General Barnett in their remarks at the beginning of these hearings underscore the importance of having rules that do not deter pro-competitive aggressive competition. As Chairman Majoras stated in her remarks: "There is consensus that antitrust standards that govern unilateral conduct must not deter competition, efficiency, or innovation. This is why we frequently worry about false positives. Pervasive and aggressive competition, in which firms consistently try to better each other by providing higher quality goods and services at lower costs, is crucial to maximizing consumer welfare and economic growth."

Assistant Attorney General Barnett echoed one of our chief concerns as a business that devotes considerable resources to antitrust compliance by stating that antitrust rules in the unilateral conduct area must set forth "clear objective standards that businesses can follow and that are also administrable for enforcers, courts, and juries". Particularly in the area of pricing behavior, as the Supreme Court has emphasized on many occasions, and Mr. Barnett endorsed in his remarks, antitrust rules must avoid chilling legitimate price cutting. This requires objective standards that rely on information that is available to corporate decision makers when they act and that allow more efficient firms to exploit their cost advantages. Sound antitrust policy also requires sensitivity to the potential misuse of the antitrust laws by less efficient competitors to reduce price competition.

Government enforcement policy has been appropriately cautious in the area of pricing, taking heed of the risk of chilling the very conduct that the antitrust laws seek to encourage, that is, aggressive price cutting.

At the same time, the

enforcement agencies have aggressively pursued many other forms of conduct that anti-competitively creates or maintains monopoly power.

Without getting into the merits of any individual case, it is important to note that the agencies have pursued a number of different forms of conduct under Section 2 theories. Recent cases include patent settlements that may delay entry and thereby extend an incumbent supplier's exclusive rights to supply, representations to standard-setting organizations or governmental bodies regarding patent positions, exclusive dealing, and product design cases.

The enforcement agencies have recognized the challenges inherent in aggressive enforcement of Section 2 cases. While bringing a number of Section 2 cases in recent years, the agencies have also expressed cognizance of the potential misuse of the antitrust laws by less efficient rivals.

As Deputy Assistant Attorney

General Masoudi has noted elsewhere, an antitrust agency must be cautious about complaints it receives from competitors. Such complaints often try to avoid legitimate competition by seeking protection from the government from competitive pressures.

This is particularly true when the subject of such complaints it price cutting. We hope that the agencies' final reports on these hearings will impart to the courts the benefit of the agency's experience in enforcing the law aggressively while resisting the demands of complainants who seek to use Section 2 to dampen competition.

I read with considerable interest the assertions that were made at the January 30th hearing that the enforcement agencies have been asleep on the job or that they have somehow failed to enforce Section 2. This view simply cannot be squared with the record of aggressive enforce that I've just outlined.

It was also suggested at that hearing that the enforcement agencies have given the high-tech area a free pass, even ignoring the fact that high tech is not limited just to the computer industry. This claim is equally hard to square with reality.

The Agency's most recent actions in the high-tech area include monopolization cases against Microsoft and Rambus, a substantial number of merger enforcement cases involving companies -- software companies such as Oracle, PeopleSoft being the best known, and many other high-tech market cases including communications technology, disaster recovery systems and 3-D prototyping. Also massive fines imposed on DRAM companies and jail sentences on some company executives and ongoing criminal investigations involving SRAM, flat-panel displays, and graphics processors.

The criminal cases and investigations are particularly notable because they involve price fixing, conduct designed to and having the effect of making consumers pay more. It seems eminently sensible that antitrust enforcement should direct itself at conduct that demonstrably leads to higher prices rather than to attacking price cutting which is the very conduct that the competition laws are designed to promote.

It was suggested at the Berkeley hearing that antitrust enforcement should be directed at price cutting and that the reality, as opposed to the myth, is that consumers are harmed when prices come down due to discounting.

Here I could not disagree more with the position espoused by AMD. On the issue of discounting we have a fundamentally different point of view. We think that enforcement resources are appropriately directed at conduct that makes consumers pay more, not conduct that gives them lower prices.

I believe that our position is supported by both the law as articulated by the Supreme Court, and by very sound policy considerations that underlie the Court's decisions. The Court's statement in Matsushita cogently expresses both the policy and its underpinnings. To quote: "Cutting prices in order to increase business often is the very essence of competition. Thus mistaken inferences in cases such as this one are especially costly because they chill the very conduct the antitrust laws were designed to protect."

Justice Breyer, while sitting on the First Circuit, made a similar observation in the Barry Wright case. Again quoting: "the consequence of a mistake here is not simply to force a firm to forego legitimate business activity it wishes to pursue; rather, it is to penalize a procompetitive price cut, perhaps the most desirable activity from an antitrust perspective that can take place in a concentrated industry where price typically exceeds costs."

This policy has broad application across all areas of pricing conduct. As the Supreme Court said in the Arco versus USA Petroleum case: "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition". We have adhered to this principle regardless of the type of antitrust claim involved. This is not only the law, but it is also the right antitrust policy.

This policy recognizes that false positives, which are very likely to occur in the absence of clear-cut cost-based rules, can impose a high cost on society by punishing and thereby deterring aggressive price competition.

The courts and the enforcement agencies have recognized that the very tangible bird in the hand, that is lower prices enjoyed by consumers today, must not be sacrificed for the bird in the bush, the speculative and almost always illogical hope that attacking price cutting and thereby producing higher prices today will somehow produce lower prices tomorrow.

I can tell you from years of experience advising a very successful corporation on how to compete with a very aggressive rival that the need for clarity in this area is paramount. The challenge in counseling a business is to ensure that the company adheres to its legal obligations without forcing it to engage in gentlemanly competition in which business opportunities are squandered by pricing higher than is needed to win the deal, even though the deal can still be won profitably.

Intel has long enjoyed a cost advantage due to its strong leadership position in manufacturing. And it is important to me and to the other lawyers advising our management that we neither deprive the company of the competitive advantage that comes from its hard-won, lower-cost position nor deprive consumers of the benefit of lower prices, simply because of unclear antitrust rules.

You may have recently read on the front page of the New York Times about Intel's latest breakthrough in semiconductor manufacturing technology. This is the most significant change in the materials used for the manufacture of silicone chips since Intel pioneered the modern integrated circuit transistor more than four decades ago.

It is no accident that Intel

was the first to achieve this breakthrough. Our company has enjoyed unparalleled leadership in manufacturing for most of its existence, and the benefits of this relationship position are very tangible.

With every new generation of manufacturing technology, each of which is introduced on a roughly two-year cycle, we double the number of chips that can be produced on a wafer, holding both the wafer size and the chip design constant. This means that the manufacturing cost of any given chip is cut by roughly 50 percent when the new manufacturing technology is introduced.

Now, it's a little bit more complicated than that because we tend to take advantage of this lower cost to put more features onto the chips which trades off some of that cost savings for better performing products. But the cost advantage of being first to adopt the new manufacturing technology is large and tangible. Our recent manufacturing technology breakthrough will ensure that we can continue to progress along the same path for many years to come.

So Intel has been on average nine months to a year ahead of its competitors in adopting these new manufacturing technologies. This means that in any given two-year cycle, we are alone in achieving the cost savings during the first year, and we are ramping up on the new manufacturing process during the second year when our competition is just beginning to introduce the new technology.

Our sales executives and our management want to use the cost advantage that they enjoy as a result of our manufacturing leadership to win business. Clear antitrust rules are essential to my ability to guide them through the winning outcome to do nothing more than exploit our competitive advantage.

A clear and sensible rule is offered by the Areeda & Hovenkamp treatise in its latest supplement. Quoting from that treatise:

"When a discount is offered on a single product, whether a quantity or market share discount, the discount should be lawful if the price, after all discounts are taken into account, exceeds the defendant's marginal cost or average variable cost. That is, such discounts are covered by antitrust or antitrust's ordinary predatory pricing rule."

A similar approach has been proposed by former FTC chairman Tim Muris, who advocates a modified Brooke Group test based on whether the price of the total amount of goods sold exceeds the cost of the goods.

Cost-based rules have a number of advantages beginning with the avoidance of false positives. They enable companies to base pricing decisions on what they know, that is, their own cost structure and the relationship of price to cost instead of speculation about the meaning of potentially vague jury instructions that might, for example, say that a firm must be allowed to compete aggressively but that it cannot behave in an unnecessarily restrictive manner.

Because cost-based rules are more predictable than the vague standards that have been applied by some courts in Section 2 cases, they are also inherently more administrable. And they appropriately condemn the type of discounting that does cause competitive harm, i.e. predatory pricing.

The antitrust laws are a powerful instrument for consumer protection, but they can also be misused by rivals to attack competition. It is essential that the antitrust rules in the pricing area protect consumers both from anticompetitive conduct that may create, maintain, or enhance a monopoly, and from anticompetitive abuses of the law by rivals that seek to stifle price competition.

Thank you once again for the opportunity to provide these comments.

(Applause)

MS. GRIMM: Our third presenter this afternoon is Bruce Wark. Bruce is the Associate General Counsel for American Airlines, Inc., where he's been since 1993. His responsibilities include litigation and regulatory matters, including those relating to airport access, airport rates and charges, aviation disasters, patents and trade secret litigation, international competition, airline alliances, and antitrust and consumer class actions.

Bruce serves on the ABA Air and Space Law Forum and has written a number of articles relating to legal issues affecting the airline industry.

He received his JD from Georgetown University Law Center with Honors. Bruce.

MR. WARK: I absolutely view it as a privilege to be here today, so I'd like to join others in their opening comments by thanking the DOJ the FTC for the opportunity to appear here today.

As an in-house attorney at American Airlines who is responsible for competition matters I hope to offer a unique perspective, one that has been defined by the important, turbulent, and highly competitive nature of the airline industry.

I've chosen to focus my comments on Section 2 predatory pricing claims because within the last few years there have been two Circuit Court decisions relating to predatory pricing in the airline industry.

More specifically, these cases address the legality of decisions by carriers like American to match the prices of new entrants and to adjust capacity in response to the new price points in the marketplace.

The Department of Justice actually brought the first of these cases against my client, American Airlines in 1999. I'm happy to say, as I'm sure many of you are aware, we prevailed in that dispute when in July of '03 the Tenth Circuit affirmed an order granting summary judgment.

That decision found that the Department had failed to establish that American had priced its products below an appropriate measure of its cost as required by the Supreme Court's decision in, among other cases, the Brooke Group.

The second recent predation decision in the airline industry came in a case that was brought by Spirit Airlines against Northwest Airlines. As in the case against American, in that case the District Court held that Spirit had failed to prove that Northwest had priced its products below average variable costs on the routes in question, and therefore, the District Court entered summary judgment.

On appeal, and unfortunately in my opinion, the Sixth Circuit reversed in a decision that, I believe, fails to apply the objective standards that are absolutely necessary to distinguish between aggressive competition and illegal predation under Section 2.

I want to use these two cases today to support two important themes. The first is that predatory pricing claims unconstrained by objective standards and based on unproven economic theory harm the competition that the antitrust laws were intended to protect.

As Judge Easterbrook has

explained, and I'm quoting here: "An argument that a practice is predatory is likely to point to exactly those things that ordinarily signify efficient conduct. Unless we have some powerful tools to separate predation from its cousin, hard competition, any legal inquiry is apt to lead to more harm than good."

Given the general agreement that almost all price reductions, sales increase, additions to capacity and so on are beneficial, we need very good ground indeed to treat a particular instance of such conduct as unlawful.

The second and related point that I want to make is that these objective standards should be clearly articulated. The point was made earlier this morning that at least in the area of Section 2, predatory pricing was an area of relative clarity. If that point is true, it's true only on a relative basis.

Our experience with the Department of Justice shows that there is still a great deal of ambiguity about what the standard should be or even how those standards should be applied. And as I hope to make clear with the rest of my comments today, it's also clear the courts aren't consistently applying these standards, as I think they need to be.

Clarity on these points is particularly important because the antitrust laws can be punitive. The serious consequences of finding that the antitrust laws have been violated forces companies to pull their competitive punches, especially when the lines of aggressive competition and illegal conduct are not clearly delineated.

Moreover, even if the defendant prevails, as we did in our case, merely having to defend a Section 2 case is a very expensive proposition, and it diverts a tremendous amount of management attention and company resources.

Now, in making those comments, I recognize that given the complexity of markets and U.S. business, perfect clarity of legal standards may really be an unobtainable goal. Individual cases will continue to have to be decided on their own merits, and general legal principles will have to be applied to unique facts.

That said, improving of clarity of legal standards in this area should be pursued, and there are areas where clarification can be immediately accomplished such as a clear endorsement of average variable cost as being the only appropriate measure of cost in a predation claim.

In our industry, despite the fact we have two fairly recent Circuit Court decisions addressing predatory pricing, Section 2 standards remain unacceptably vague. And even worse, as I've indicated before, I believe the Sixth Circuit decision in Spirit fails to demand the objective standards that are necessary to show that aggressive competition has overstepped the bounds of the law and is a decision that protects smaller competitors rather than competition on the merits.

Before discussing the American decision and the Spirit decision in more detail, I think it's useful to give some general observations on the airline industry and how we compete.

The airline industry is the backbone for much of U.S. commerce, and the antitrust scrutiny that we find ourselves under is no doubt a product of the important role that the industry occupies.

Last year alone American served about 100 million passengers. We took in about 20 billion in revenue. Yet those figures, as impressive as they are, account for only about 20 percent of the U.S. domestic airline industry.

Until the early 1980's, the airline industry was a regulated business. But since deregulation, the industry has exploded, and air travel today, although far from perfect, is largely affordable and convenient.

Airfares in real terms have fallen significantly, and American and other carriers are now able to offer thousands of convenient on-line connections that did not exist in the regulated environment.

At the same time, new entrants are consistently entering the market with new aircraft, lower costs, and new ideas on how to succeed in this crowded and mature marketplace. One or more of these low-cost carriers operate in over 80 percent of the routes that American flies.

Clearly, competition has served the air traveler well. Shareholders and other stakeholders haven't faired quite as well however.

American is the only Legacy Network carrier that's never filed for bankruptcy. And since the turn of the century, we've lost billions of dollars and have had only one profitable year, that was last year, where we eeked out a profit margin of roughly one percent.

These results here aren't intended to engender your sympathy, but simply to remind us that the competition in this industry is not only very dynamic. It's often brutal.

Each day the people at American have to make decisions on how they're going to price tens of thousands of markets, and in doing so they act on an experience base that tells them two things. First is that air travelers are going to be motivated by small differences in price. Second, that we are operating a network of interconnected routes. And when we make decisions as to one route, there may well be implication for other routes within that same network.

Given our cost structure and position in the marketplace, maintaining a robust network is a competitive imperative to us. Our business folks are designing strategies that we think maximize our success, and that success has been and always will be adversely related to the success of our competitors. In sum, we are convinced that we have to be an aggressive competitor, and, in our business, that competition will always start with price.

As the world's largest airline operating in this competitive environment, we understand the importance the antitrust laws play in our market-based economy. We have a longstanding antitrust compliance program, but the ambiguity in the law and the very competitive nature of the industry make it a challenge to provide clear guidance on Section 2.

The fact that we hope to accomplish this legal guidance under the circumstances is to sensitize our clients to potential issues and be prepared to answer those questions in real time as issues arise.

For reasons that I've already mentioned, pricing doesn't remain constant, and being noncompetitive on price for even a short period of time can be very costly. Our advice has to be as real time as the competitive market in which our clients are operating. And overly conservative advice can inflict substantial damage on the company.

We don't have the luxury of a week to pull data and analyze issues, although we know that if we end up in a dispute, those on the other side will review that data with the luxury of both time and hindsight and will be seeking to substantiate a position that is predetermined by the requirements of its claim.

As I'll explain shortly, I believe that's exactly what happened in Spirit's case against Northwest when it was able to avoid summary judgment.

Moreover, we have learned through our experience that the Department of Justice's attorneys and economists have their own views of competition in the airline industry. And our views of competition in the industry and those of theirs are often at odds.

We have the right to challenge those factual and legal assumptions as we did in our lawsuit, but that is a position that we desperately try to avoid. Given the punitive nature of the antitrust laws and the inevitability of private class action litigation, including the prospect of treble damages, defending ourselves in that situation, irrespective of the courage of our convictions, is high-stakes poker indeed.

Thus, I thought of several examples in which we have given advice or altered our conduct based not on what we thought was illegal, but on what we feared others might argue is illegal. And in these circumstances competition has likely been compromised.

Our experience with the Department in its predation case illustrates how Section 2's lack of clarity can lead to significant disagreement between industry enforcement and how, at least in our opinion, overly aggressive enforcement actions threatened the competition that the antitrust laws were intended to protect.

In making that comment, however, I want to note that although we disagreed with the Department's theories and decisions in that case, we didn't question their good faith. Despite those differences of opinion, I don't doubt that they decided to pursue the case against American, and they believed in the merits of their arguments and believed that they were fulfilling their obligations to protect competition and consumers.

Indeed, if they're like a lot

of lawyers that I know, I suspect that despite the loss, they still think they were right and it's the courts that got it wrong.

These good-faith but extremely important disagreements simply highlight the problem of the current state of jurisprudence under a Section 2 predation claim.

Let me put our dispute with DOJ in a bit more historical context. The lawsuit was brought in the mid to late 1990's, at which time the airline industry, like the rest of the U.S. economy was operating near the peak of the business cycle. American and other large network carriers were profitable. And although those profit margins were generally in the single digits and was modest compared with other industries, they were very good when compared to the industry's historical returns.

In response to these conditions, a number of new entrants entered the market, some such as Frontier and Air Tran are still flying today and are generally recognized as being successful. Other new entrants that were less well managed and financed disappeared.

The failure of some of these new entrants led to concerns that the markets were failing and that the actions of incumbent airlines, like American, where we matched pricing and expanded output was actually harming competition.

The Department of Transportation even considered reregulating the industry when an incumbent carrier matched prices or expanded output in response to new entry.

Fortunately, that regulatory initiative failed, and the following five or so years demonstrated that the marketplace was far more resilient and dynamic than the average regulations demanded.

By the year 2000, Jet Blue and others had shown that a well-financed and managed new entrant could succeed. And ironically, a lot of that growth was in the hubs of network carriers like Denver and Atlanta, which were once deemed fortress hubs. Perhaps even more ironically, the alleged predators like American and Northwest either filed for bankruptcy or teetered on the brink, while new entrant low-cost carriers became the most profitable and fastest growing segment of the market.

The Department's case against American and Spirit's case against Northwest both raised an array of factual and legal issues. I don't intend to address each of those, but I instead want to focus on what I think are two of the most important, the first being the definition of relevant market, and the second being the appropriate measure of cost, and more particularly whether average variable costs is the appropriate standard.

Let's start by addressing how the Sixth Circuit dealt with the question of relevant market in its Spirit decision. As mentioned in that case Northwest matched Spirit's pricing and it increased its capacity on routes served by Spirit, which arguably forced Spirit to withdraw from the route. Yet even after Northwest reduced its price and incurred additional costs, its revenue on the route exceeded any reasonable measure of its average variable costs. As a result, if you define the relevant market as airline services on these routes, Spirit's case failed because it could not show that Northwest had priced its product below an appropriate measure of its cost as required by Brooke Group. These undisputed facts are what led the District Court to enter summary judgment.

The Sixth Circuit reversed on appeal. The Court concluded that Spirit and the experts established a genuine issue as to a different definition of relevant market, one that divided passengers flying on the same airplane.

In order to reach the conclusion necessary to its claim, that is that Northwest's revenues in some relevant market were less than its variables costs, Spirit's experts had to exclude some portion of revenue that Northwest is earning on these routes during the alleged predation period.

They accomplished that objective by removing revenue of two types of passengers. First they excluded revenue from passengers traveling on any type of connecting itinerary. And second and even more surprisingly, they removed from the calculation passengers who paid more than $225 for their ticket.

That analysis, of course, was completely unrelated to any analysis that Northwest would have undertaken at the time it decided to add in price due to capacity on these routes. Northwest instead would have asked a much more straightforward and appropriate question, that is, with new lower fares and additional capacity, would it be able to generate sufficient revenue from any and all types of passengers to cover its costs? A yes answer to that question should have been the end of Spirit's claims.

Spirit's segregation of passengers who paid more than $225 from those who pay less than $225 into separate markets is an artificial after-the-fact analysis that should not have created any genuine issue of fact.

As a result, the Sixth Circuit's Spirit decision is one that harms rather than promotes competition. The endorsement of that contrived analysis, at least for the purpose of avoiding summary judgment, puts some common carriers in a no-win situation of one, either not competing for every passenger on price and product; or two, recognizing that if it's too successful, it may have to face a treble damages jury trial brought by a competitor.

Pricing capacity decisions in the airline industry are made in the context of a very dynamic marketplace, and no airline can possibly anticipate how the next plaintiff may segregate passengers on the same aircraft in the separate relevant markets, each of which is supposed to independently clear the test of a predatory pricing claim.

I'd now like to turn to the question of whether a defendant priced its product below an appropriate measure of its cost. That of course was the issue that was determined in our case. It was also perhaps the most hotly disputed issue in that case since the facts showed that American's revenues on the routes exceeded its average variable costs. This caused the department to develop alternative tests. American had argued against cost measures that included as much as 97 percent of total costs. And others had argued in effect that American's decision failed to maximize its profits.

My point for purposes of this hearing is simply this. There was a great deal of disagreement as to what items of cost were properly included, how these costs should be calculated, and how revenues should be attributed to incremental costs.

Although we prevailed on this basis, the Tenth Circuit decision left many of these disputed questions unanswered.

The Tenth Circuit also left unanswered the important question of whether there should be a meeting competition defense in a Section 2 context.

The problem of residual uncertainty in the Tenth Circuit case concerning these questions however is not nearly as problematic in my mind as the Sixth Circuit's treatment of this question. And what I believe is certainly the most troubling statement in its decision, the Sixth Circuit stated, and I quote here: "Even if a jury were to find that Northwest's prices exceeded an appropriate measure of average variable costs, the jury must also consider the market structure in this controversy to determine if Northwest's deep price discounts in response to Spirit's entry and the accompanying expansion of its capacity on these routes injured competition by causing Spirit's departure."

This statement from the Sixth Circuit offers no objective standard for the jury to use in distinguishing aggressive conduct by a large but efficient incumbent in the marketplace. It employs none of the powerful economic tools called for by Judge Easterbrook, and is inconsistent with the dictates of the Supreme Court. It simply constitutes an open invitation for juries and courts to condemn aggressive competition in order to protect less efficient but smaller competitors.

I want to wrap up my comments

by offering some specific suggestions concerning Section 2 enforcement. First, given the ambiguity in the law and harm that a false positive can have in this area of the law, regulators should proceed very cautiously. I believe that especially in the context of a single product pricing case, regulators and courts should heed the Supreme Court's guidance that well-founded claims are extraordinarily rare, and that overly aggressive enforcement can harm competition.

Predatory pricing claims are not an area of the law where regulators should pursue aggressive new theories or rely on untested economics.

Second, markets are more resilient than is often appreciated at the time. The experience in our industry has debunked many of the theories and assumptions concerning the market, like that of the fortress hub that motivated the Department of Transportation to consider re-regulating the industry and encouraged the Department of Justice to file its lawsuit against American. Trusting markets to perceive shortcomings is often the best policy.

Third, definitions of relevant markets should align with the competitive environment, as it was perceived at the time by those whose conduct is being contested. Relevant market definitions contrived by lawyers and economists after the fact are often motivated by predetermined results and almost always fail to account for the full complexities of the market.

Fourth, I believe there should be a meeting competition defense under Section 2. Such a rule would provide a clear line, and matching a competitor's price in the hopes of competing for every last customer is exactly what competitors are supposed to do. A competitor that cannot survive at the price point it has chosen is not the type of efficient competitor the antitrust laws should be protecting.

Finally, since aggressive competition and predatory conduct often share the same characteristics, careful thought needs to be given to the remedies before the regulators commence litigation.

There were times in our dispute with the Department that we would have liked to resolve our differences, but the remedy imposed by the Department would have been competitively debilitating for American in a highly competitive industry.

Finally, predatory pricing is an area of the law where remedies are more prone to doing more harm than good. I hope that these comments have been useful, and I look forward to the moderated portion of the discussion.

(Applause)

MS. GRIMM: I'd like to thank our presenters for their very fine presentations. We will be resuming in about 15 minutes. We'll take a break until then.

(Break Taken)

MS. GRIMM: I would like to start at the end with Bruce Wark. Bruce, do you have any comments? Do you have any questions of your fellow panelists?

MR. WARK: Well, there was a great deal of commonality, I think, between what I said and what Bruce Sewell said. So

I'll just tell you -- say he was right and leave it at that.

On the question of convergence, I agree it's an absolutely important policy goal and needs to be pursued. But equally importantly, you need to make sure you converge at the right place. And you know, particularly with the E.U., they have a different tradition. They have different biases. I think they are more inclined to protect competitors at the expense of competition. And what I wouldn't want to see is convergence away from what we think is the right standard, which has been developed in this country. And I think the standards employed in this country are the gold standard and we need to stick with them.

MS. GRIMM: Bruce.

MR. SEWELL: Yeah, I obviously return the favor, Bruce. A lot of mutual admiration here.

I guess a couple of the points that were made in your comments that I picked up on, we absolutely agree that average variable cost is the appropriate measure, and I think we're going to explore that a little bit more. But we absolutely and wholeheartedly agree.

The other thing that I noted and I'd like to just sort of reinforce this, I think one of the things I took from your comments was this notion that if you were to try to run a business so as to avoid being sued for potential anticompetitive behavior, that almost by definition then you have under-optimized from a consumer standpoint. And that's something that we need to be aware of. And that the risk of lawsuits and the potential punitive aspects of those private lawsuits is enormous. And yet at the same time as a company you almost cannot run your business to say I will never put myself in that position. It under-optimizes.

With respect to Sean's comments, again, we're very supportive of this activity. The critical question, as Bruce mentioned, is if you harmonize regulation, if you adopt in effect a single form of regulation, then it's just so important to make sure that you don't go to the highest regulatory level so that you don't end up in effect, in order to get consensus, always choosing the most regulatory or the most highly regulated standard. That would be an easy way to get to convergence, but it's not necessarily the best way to do it. That's about it.

MS. GRIMM: Sean, do you have some comments?

MR. HEATHER: I would just say to clarify what the Chamber's testimony was in response to both the observations that were made. The Chamber is not about convergence for convergence sake. That it is important that the right standard is picked and would agree that, we believe that, the way in which the U.S. looks at these issues is the gold standard. And the importance is taking that gold standard, and as my father would say, and de-Anglesizing the rest of the world to it. So it's not about convergence for convergence sake, but it definitely is obviously the theme behind the remarks I made.

MS. GRIMM: Thank you. I

would like to delve into this question of average variable costs in some more detail. Both of our Bruce panelists have definitely endorsed that as a test, I would say. And I would just like to ask each of them to basically tell us more about how average variable costs are kind of arrived at in their particular industry.

This morning we heard one of our panelists say that he did not think average variable cost was the right test, especially in high fixed cost industries. And I would just like to hear some more discussion from you on how the average variable cost test would be applied.

MR. WARK: Yeah. Want to begin with me again?

MS. GRIMM: That would be fine.

MR. WARK: I think it's important to recognize that average variable cost is really a proxy for marginal cost because that really it the right test.

And when you talk about average variable cost, one of the questions that gets buried in the next level of analysis is variable over what period of time because, you know, everything is variable if you give it enough time.

That said, I do think that average variable cost on an appropriate time frame is the best test because it provides clear guidance. And I think the problem you have with people who argue that maybe it doesn't fit in one particular case or another, there really is no other standard that they're articulating. And you end up in a situation like what I pointed out in the Spirit case where the Court's basically saying well, even if they don't meet average variable cost, you the 12 jurors decide whether you think this scenario is good for competition or not. And that is the kind of unobjective predatory pricing analysis that is surely going to result in false positives and will create all kinds of problems, from a counseling perspective, but also, I think, as far as consumers should be concerned.

MS. GRIMM: Bruce?

MR. SEWELL: Sure. Let me

start with one of the principles that I tried to make in my written statements. The laws that we're seeking to conform need to be understandable by the people who are asked to adhere to them. And that leads you to look for ways that you can translate concepts that are relevant for antitrust enforcement into concepts that are also common for business people.

And average variable cost is a measure which is widely understood by business people, and I would argue particularly in my industry, potentially in Bruce's too, it's a metric that exists for other than just antitrust enforcement purposes, which means that it's also a metric which exists for legitimate business reasons, and therefore has some additional validity, I think, when you're asking for companies to talk about average variable costs.

We at Intel have a model which enables us, and in fact we do a lot of our business planning based on average variable cost or marginal cost.

Once the fabrication plant

has been built, we have to track the cost of the wafer through that plant. And we've become quite expert at understanding and identifying the various components that have to go into creating a final finished microprocessor, so the cost of the wafer, the cost of the electricity to power the wafer through the plant, the cost of the etching and the chemicals. All of these constituent pieces that go into actually moving the wafer through the plant itself.

And this is a model. It's a metric that we use regularly in business. So for that reason, both intellectually, I think, is the correct way to look at the price in question from an antitrust perspective, but it also has that added benefit of being something that business people use in the ordinary course of business, and therefore it has that extra validity.

MS. GRIMM: I'm going to follow up with what might be a naive question, but what is the average variable cost of a microprocessor that you produce?

MR. SEWELL: I can't answer that today. I could get you the answer very quickly, but I can't answer it off the top of my head. It would depend on what microprocessor you're talking about. So we have a number of different product lines running through different plants at different times on different processes. And the answer for one of those would be different, but it is known.

MS. GRIMM: But it is known?

MR. SEWELL: Yes.

MS. GRIMM: In other words, you could go to one of your business colleagues and basically say give me that information and it would be readily available; is that correct?

MR. SEWELL: Correct.

MS. GRIMM: Sean, I'd like to find out more about your project that you're heading. I very much would. And I'd like you to share some additional information on how it is organized.

You mentioned that divergence in standards is one of the things that you're looking at. If we could get more information on that, that also would be helpful.

MR. HEATHER: Sure. I start with this as background. In 1947 the average tariff between industrialized nations was 47 percent. Today it stands at less than five percent. And that's because when international countries got around the negotiating table during the last 50 years, they began to find ways to open up markets.

And so now with the Doha Round is hopefully coming to a successful conclusion, and we all cross our fingers that it will happen in the next few months, that those barriers to trade will continue to diminish over time.

What is left behind is what we call in-country barriers, and we put these into kind of six buckets. Divergence in competition policy, intellectual property rights, standards, state-owned enterprises and subsidies, investment restrictions, and government procurement issues.

In these area, we think that the existing policy tools that international countries have, whether it be through bilateral, multilateral, or organizations like the WTO, there's an adequate mechanism by which to address these problems.

And so these kinds of in-country barriers are important going forward if we're going to protect a global economy and I think continue to go after open and competitive markets in a way which builds on what we've done in the past.

So the U.S. Chamber aims to begin to focus the U.S. government and governments around the world to meet this challenge over the next 50 years in the same way in which the world took on the challenge to opening up markets in a tariff-related sense.

In terms of how we're organized, we have got a number of member companies that have been members of the Chamber who have expressed specific interest in this project, see the need for it, see that this being the future of trade discussions and negotiations. And so they've challenged us to take this project on and moved forward. And we have them serving in a steering capacity.

We are advancing on a number of different fronts in each of these different buckets, including today on the competition policy front.

I think most notably in the news these days is Chancellor Merkel, the E.U. president, German Chancellor, has advanced the notion of a cooperative dialogue between the U.S. and the E.U. on regulatory issues. And so we're going to start there.

Then additionally we'll begin to work through international department on China. We see that in a working partnership with the Treasury Department and the Strategic Economic Dialogue that's in place advancing these same kinds of principles and goals to bring about some sort of regulatory playing field that's more common than the patchwork that we see currently existing.

MS. GRIMM: You mentioned tying and essential facilities as two areas that you're particularly concerned about, and those are also the areas that you highlighted in your comments that you submitted in September.

Are there any areas aside from tying and essential facilities that you are concerned about internationally?

MR. HEATHER: Internationally, let me answer that by saying this. We are interested in making sure that again this is not convergence for convergence sake, but that there is a uniform standard that's being applied by antitrust jurisdictions around the world, and that standard is one that is resonating from what we see here in the United States happening.

So while the comments that we made back in September talked about tying and essentially facilities, our concerns internationally go beyond that to any particular Section 2 type action, whether it be Article 82 of the E.U. or similar laws in countries around the world.

And I think the reason which we brought up the tying and essential facilities was because one of the concerns that was expressed, if you create a standard that is of the highest magnitude, that companies will then have to move to that, and then it would be detrimental. And I think that's particularly important to the issue of intellectual property.

When you think about intellectual property, if you have as enforcement and remedy a disclosure of intellectual property, you can't contain that disclosure within a geographical jurisdictional of France or the E.U. Once the cat's out of the bag, the proverbial cat's out of the bag, it spreads quickly across the rest of the known world.

So I think it's important that we highlighted essential facilities and tying arrangements because I think we see a lot of that being where the divergence is today. But more broadly, you would want to see convergence around Section 2 issues.

MR. MATELIS: Following up a little bit on that, Sean, assuming that convergence might not be happening overnight, you mentioned a couple times in your speech principles that could be used in areas where there's not convergence. You mentioned Assistant Attorney General Pate's reference to comity principals. And then later in your discussion you mentioned agreements to defer among international competition agencies.

I'd be interested in your thoughts on that area in general. And Bruce, I suspect this is something you've thought about as well, and Bruce you as well have at it.

MR. HEATHER: In my comments, I think you're referring to where we talked about enhanced comity. And while the U.S. Chamber's not at this point prepared to say enhanced comity is the exact way to go, we believe that exploring that further is a potential option.

I think that one of the things you could do in terms of creating standards across the board is potentially the use of safe harbors, in the sense of safe harbors in what I believe would be termed the positive saying that if you have a dominant market share position of 50 or 60 percent, that

that is not defined as a dominant position, or to suggest certain conduct regarding tying or rebate policies and the like does not constitute an abuse of the dominant position. Coming up with some standards that could be adopted internationally would be one way by which you could put that kind of language into agreements between countries and then exploring the area of enhanced comity where potentially you could defer to decisions of other jurisdictions.

MR. SEWELL: Yeah. On comity first and then on safe harbors. The reality is that sovereign countries and sovereign trading blocs, that's the right way to describe the E.U., are going to regulate, are going to exercise their sovereignty. That's perfectly within their right to do so.

The problem, I think, is when you have agencies which are really reaching outside of their own geographic or area of sovereignty in trying to regulate conduct which occurs outside of that area.

So for example, where you

have an agreement between two U.S. companies to price at a certain level, and then that gets reviewed in a third country which is not the host of either of those two companies. And the analysis then becomes can two U.S. companies price in a way which the U.S. would find acceptable but yet some other agency does not? And in those circumstances I think the principles of comity should really be argued and be respected by the agency that's outside of the -- in this case outside of the U.S.

Where there is a clear nexus back to non-U.S. competition, so in the case of Europeans, where there is a European actor involved, that's a more difficult argument to make.

But certainly where there is no European actor involved and where there's a tenuous connection at best back to European commerce, then I think it's important that issues of comity are respected.

With respect to the safe harbor question, I actually think -- I agree with you entirely that we are not going to get international convergence or harmonized antitrust laws any time soon. But I think there is a role for the safe harbor here. I think there is a threshold standard which some number of these 100 antitrust regulatory agencies around the world might be willing to agree should represent the -- sort of the bare requirements with respect to antitrust conduct. And that so long as companies are complying within that threshold standard, that companies should at least have a safe harbor from punitive litigation.

And it might be that that's the first step in driving towards what would ultimately become a more harmonized set of international standards.

MR. WARK: I really don't have a whole lot more to add on that issue. I think the points have been well made.

MS. GRIMM: I'd like to ask our panelists a question similar to that that was asked of our morning panel, and that is in the area of loyalty discounts, whether market share provides a useful screening mechanism in assessing the legality of such discounts, why or why not. And Bruce Sewell, maybe you can take a shot at that first.

MR. SEWELL: Let me start with what I think you're asking and then feel free to probe a little bit.

I don't fundamentally see the loyalty space as different or as requiring different treatment than a standard pricing inquiry would demand. So I don't see perhaps the relevance of the market share test.

It seems to me that whether the discount is in the form of a loyalty discount or some other form, the essential inquiry remains the same. Is the price that's being offered across the units being sold above or below a predatory level? And if the answer is that the price is above what we've defined as a predatory level, then I think that ends the inquiry.

If the price it below a predatory level, then I think there are remedies available and laws available to deal with that. But I don't see it as a different analysis.

MS. GRIMM: Bruce Wark, do

you have anything to add to that?

MR. WARK: Yeah. I think I bring almost a unique perspective because I think we have one of the world's most famous loyalty programs. It's called Advantage. And I think that anybody who looks at that and looks at how the loyalty program at least in our industry has grown up, it's absolutely pro-competitive. It's a point of competition that airlines engage in.

On the other hand it's not exclusionary. It's clear that new entrants have been able to enter markets, either by developing their own loyalty programs, hooking those loyalty programs onto the loyalty programs of other airlines who may want to do the same thing, making their loyalty programs maybe quicker and easier to redeem.

Or take the example of an airline like Jet Blue, which may say well, maybe what I'll do is I'll compete on some other ways and product.

So I think the Advantage program in the airline industry is a great example of how loyalty programs can in fact be very pro-competitive.

As far as the point that Bruce Sewell just made, I tend to agree with him. Unless you've got some kind of -- if you can equate the loyalty program with making it exclusive, then maybe you have to analyze it in an exclusive dealing context rather than a predatory pricing context. But certainly our program doesn't work that way, and many don't.

MR. SEWELL: And I'd add to that too that really the way to look at loyalty discounts is these are incentives to buy. These are not punishments for failure to buy. And that's a really fundamental difference.

So the focus on incenting behavior and providing an advantage to buying more is different than threatening to punish in the event that a supplier were to -- that a customer were to buy from a different supplier. Very different kinds of things and should be treated very differently by the antitrust laws.

MR. WARK: One other point I guess I want to make which goes back to the original question is what role does market share play. And again, I think the airline industry is interesting because we're 20 percent of the U.S. market, which no one's going to say is dangerously close to establishing monopoly. But maybe on an individual route or out of an individual hub we'll be 70, 80 percent of it.

So are you going to apply the 70 percent or the 20 percent? So that really gets into what's your relevant market on the loyalty program, and could you really run a different loyalty program based upon the location of the particular participants in that program.

So I think when you ask the question what market share means, at least in my mind, part of the question is being able to find relevant market for purposes of the loyalty program.

MS. GRIMM: Bruce Sewell, as I understand it, Intel has faced or is facing inquiries in a number of different foreign jurisdictions with respect to its discount policies. Have you encountered differing standards in those foreign jurisdictions? And if so, how?

MR. SEWELL: Well, I'm pleased to be able to say that I don't have the data to answer that yet because we haven't been the subject to different -- to the imposition of different standards. We are dealing with agencies around the world. As yet we have not been put in the position where we have to sort of harmonize those different issues.

Having said that though, I am concerned that the standards that will be applied, should these agencies choose to act, will be different.

And a quick example. The European Commission is now wrestling with this issue of effects based or formalistic application of the antitrust laws. Should one look at the intent, the conduct exclusively, should one look at a prescribed set of formulistic rules, or should one really focus on the effect that the conduct has in the market?

And I think in that area the U.S. leads with its willingness to study effects as opposed to exclusively conduct for a formulistic approach.

So the result that may obtain in Europe should the European competition authorities decide to bring an action against itself might be different because of the application of a different test. We're not there yet, but I worry that that's the case.

Sean mentioned the Chinese anti-monopoly law. It's not at all clear what kind of standards the Chinese would use in assessing market share or in assessing conduct under the anti-monopoly law.

It's not currently an issue for us. We're not currently under investigation in China. But it is not at all inconceivable given that we are subject to a competitor which has chosen to use a serial antitrust complaint approach, that we may find ourselves having to defend our conduct in China at some point. And I have very little confidence that I today could tell you what standards would be used by the Chinese government, how that would be understood.

MS. GRIMM: Thank you. I'd like to ask you a general question here again, both Bruces, I'd appreciate your responding.

We've talked about loyalty discounts. We've talked about predatory pricing. I am wondering if there are any other areas under Section 2 that you think need more guidance from the agencies, areas perhaps in which we could consider safe harbors, areas maybe needing the announcement of some presumptions. I know it's a broad question, but I wonder if you've given any thought to this, or in your experience that there are any other issues that you've found to be of particular concern.

MR. WARK: Let me think on that a little bit. I mean, I spoke on predatory pricing in large part because as the provider of essentially a single product, I don't run into some of the bundling issues. There aren't a whole lot of exclusive dealing concerns in my business.

And obviously having defended a predatory pricing case and having seen what happened in the Spirit case, that is the issue which is of most importance to me.

So I guess, as I listen to Bruce, I'll think whether there's any other areas. I'd be happy to have that one taken care of.

MS. GRIMM: Fair enough. Bruce?

MR. SEWELL: There isn't anything that's strictly within the antitrust context that comes to my mind, although there is this intersection between intellectual property law and single-firm dominance which I think is an area that deserves a lot more scrutiny and could certainly benefit from some clearer language and clearer standards. So that would be one.

And then I think also in this area of standardization, what happens when a firm, either because of its size or because of its intellectual property position engages in a standard-setting activity. And

I think also we could use some clarity in that space.

MR. MATELIS: This might be a different way of getting at sort of the same point, but Bruce Wark, you mentioned in your remarks that you can recall some instances where American refrained from what you thought was pro-competitive conduct out of fear of baseless antitrust suits.

Without going, you know, into the details too much, could you explain in general what sorts of things you were thinking about and, Bruce Sewell, maybe you have some perspective on this as well. And Sean, anything that your members have relayed to you would be of interest too.

MR. WARK: In the Section 2 context it became clear from our litigation experience that the Department was as much concerned with capacity decisions as it is with pricing. Now, from our perspective they always went hand in hand because when you get a lower price, you now want to compete for anybody who might be into that lower price, which is going to be a bigger universe than what you started with.

But it was at least in the DOJ's theory and it was also the theory in the Spirit case that maybe you could match the competitor, but you shouldn't expand capacity.

Also when you go back and you look at the history of what the DOT was proposing, they were basically idea of being well, you can match price, but we just don't want you expanding output.

So with that sensitivity, you know, we really do have to sit there and say okay. We have to look at the market and say well, are we comfortable expanding capacity in that market, knowing that although we think it's perfectly legal and pro-competitive, are we going to have to re-address this thing that we're adding capacity where we shouldn't.

There are a couple of other examples that primarily also we've had some other disputes with the Department about, more along the line of Section 1 cases and how we publish fares. And details probably wouldn't interest too many people here. But that's also another area where we think we would have to be conservative, in large part not because we think we're wrong, but because, you know, we're not interested in having another argument.

MR. SEWELL: I don't want to give you a flip answer. The temptation would be to say whatever happened, we haven't been very successful at it because we are currently being sued.

The structure of my industry is a little different than Bruce's. We really primarily are worried about one particular competitor. And I can't think of any situation in which we have foregone an opportunity that was demonstrable and was understood was sitting on the table because we feared a suit by our competitor.

But Intel expends an enormous amount of resources, legal resources, trying to figure out where these lines are and trying to make sure that we believe we can defend everything that we do if challenged. We fully expect to be challenged and we are routinely challenged.

So I don't think we intentionally leave money on the table, as it were, or intentionally price in a way which does not seek to provide the maximum benefit to consumers. But we spend an awful lot of time trying to make these decisions.

And as is apparent, we don't always get it right in the sense that we're not successfully avoiding the litigation. We absolutely believe that we can defend the decisions that we've made, and we'll eventually have that opportunity.

But it is a cost. It's a large cost for doing business. And it would be helped in large part by some clearer rules so that we could set systems and educate our clients with greater certainty about where the lines need to be drawn.

And then we would still probably have to defend ourselves in court, but it would be on the basis of greater certainty.

MR. HEATHER: If I heard your question right, it's do legal environments lead to businesses making decisions based on those.

MR. MATELIS: Right. And then in particular, are there pro-competitive pro-consumer business decisions that companies -- you know, your members, for instance, are avoiding because they fear antitrust liability in some form?

MR. HEATHER: Well, our members have told us on numerous occasions that obviously in the general sense that these kinds of legal environments do impact their business decisions. And we most readily track that through our Institute of Legal Reform, which has been around for the last four or five years. We release a study study annually that ranks the 50 states on whether or not they have a positive legal environment that encourages business investment or whether they have a legal environment that discourages business investment.

In that survey we haven't gone into antitrust issues, so I would leave it at generically stating that yes, there is a link between cause and effect. And obviously companies react and make their business planning based on the legal environment.

MS. GRIMM: I'd like to pursue that a little bit more in the international context again and basically ask very much the same question that was asked of our panelists this morning.

In terms of how businesses such as yours, Bruce and Bruce, respond to variations in the competition laws internationally, in particular I'd like to know, for example, whether your business decentralizes decision making as to different foreign environments. Secondly, whether your business generally seeks to comply with the most restrictive laws in those environments. I'd also like to ask whether the uncertainty could even impact on where you, for example, Intel, put your factories.

And fourth, I think maybe you answered this, but whether the difference in international enforcement standards substantially raises your cost of doing business. Those are kind of four subquestions under the large question. But if you could try to address those, it would be helpful.

MR. SEWELL: Sure. I'll start, and then if I miss one, then let me know.

We start with the position that as a global company, we need to be compliant with the antitrust laws globally. And since there is not a unified standard for that, we have to look at each area in which we do business.

For Intel philosophically, we start with the premise that we must be compliant in the U.S., and then overlay that U.S. compliance approach with foreign requirements to the extent that we can discern what those foreign requirements are.

So at any given point, we would be able to answer this question by saying we are sure we are compliant with U.S. antitrust law, and we are doing everything that we can to be compliant with foreign antitrust law although it's more difficult because that law is less certain in many cases, and in some cases even is nascent, is not really yet codified.

So we decentralize the decision making to some degree based on that model. So we have antitrust experts outside of the U.S. who focus on antitrust compliance issues in major regions, not in every single country in which we do business.

And we have pricing experts outside of the U.S. who seek to inform the pricing people within the central core of the company as to where a particular price or a discount or an incentive program might be potentially problematic outside of the U.S.

In terms of your last point, was could it impact where we might select to do business, and the answer is in general, yes. It's a factor that we consider. Because our approach is to try to say that we will be compliant wherever we do business, even if that means that we will hire lawyers and hire specialists to tell us how to do that, in the end it's a cost of doing business that we would normally absorb. And the decision as to where to locate a factory tends to be driven by things other than the antitrust laws in a particular country, because we just -- we assume that we're going to figure out how to live within those laws, and we'll absorb that cost.

The same would not necessarily be true for intellectual property laws where the risk of putting a factory into a country with punitive intellectual property laws could be much more devastating. We'll figure how to get through the antitrust issues. Some of the IP issues are sticky.

But the last point is that it certainly is that the disharmony and the lack of convergence represents a substantial and significant cost for us, and that cost could be alleviated or at least substantially reduced if we had greater consistency among the various laws.

MS. GRIMM: Bruce, would you like to add to that?

MR. WARK: Sure. The airline industry is a little different than a lot of industries in the sense that there isn't a whole lot of foreign investment is U.S. airlines in part because of law and vice versa.

So my competitive footprint in Europe, being the most important example, is small. So I never really have to worry about an Article 82 claim standing alone.

I think where those issues do come up for us is we compete with airlines like British Airways, but we also cooperate with airlines like British Airways through airline alliances.

So for example, I may be competing with them between Chicago and London, but I may be cooperating with them to move somebody from Chicago to Tel Aviv.

So we're kind of in this interesting position of sometimes competing with airlines, sometimes cooperating with airlines. That's more of a Section 1 or an Article 81 issue, although you do have this kind of concept of collective dominance. I don't know that anybody really knows what that means under Article 82. I think that's being developed as we speak.

So when we talk to the other airlines about what we can do as an alliance, I can say that we always have to fall to the lowest common denominator. I personally believe there are some very pro-competitive things alliances can and would do but for the fact that again, you're always operating on the lowest level for fear that you will stumble on what is the highest competitive hurdle.

MS. GRIMM: I have no more questions.

MR. MATELIS: Something that a lot of people have spoken about today are loyalty discounts. Bruce, let's start with you. I wonder if you could -- you know, I think most people intuitively grasp how loyalty discounts help firms get business. But I wonder if you could help tell us by tracing that through to the potentially pro-competitive effects on consumers.

MR. WARK: Which Bruce?

MR. MATELIS: Bruce Sewell.

MR. SEWELL: Maybe I'm missing something, but the trace-through from my perspective is that loyalty discounts are discounts. Loyalty discounts reduce the price that the consumer pays, and for that reason -- I mean, that is the essential and the nub of what we're trying to accomplish through regulation of competition.

So the track to me is very simple. It's a discount. As I said before, I think it should be looked at as any other kind of pricing mechanism.

Sometimes these discounts may be cash discounts. Sometimes they may be discounts in kind. Sometimes they may be incentives to cooperate in areas that increase visibility of the products or other marketing areas.

But in the end, from the perspective of a consumer, all of these discounts ultimately produce a lower price in the marketplace. And I think that's the social benefit.

MR. MATELIS: Are there cost-saving efficiencies that might not be readily apparent to somebody outside a firm, or is that not significant?

MR. SEWELL: Well, in our industry it can be very significant because issues of scale have such a direct impact on the cost. So from our perspective, there are pro-competitive and pro-business reasons for looking to expand the scale and the volume of parts that we sell.

So I'm not sure that's directly a consumer benefit, but it's certainly a business justification for the discounting practice.

MR. MATELIS: Bruce Wark or Sean, any thoughts?

MR. WARK: I wouldn't add anything to that.

MR. MATELIS: Okay. I wanted to return to something that Bruce Sewell mentioned earlier and ask it of you Bruce Wark. Bruce said that at Intel, average variable cost is a readily available figure often. Is that the case at American as well?

MR. WARK: Well, we had a very long piece of litigation where in fact there was a great deal of argument about what average variable costs should be. I think we thought we knew what it meant for purposes of that case. It was a different number than what the Justice thought the number should be.

MR. MATELIS: I don't mean to interrupt you. But outside the context of litigation, is average variable cost a concept that -- or a figure that is important to American's own internal deliberative process, or do you have different ways of thinking about your business?

MR. WARK: We have a route accounting system that takes account of all kinds of different layers of cost, from fully allocated to something that is much more variable. So yes, I think that the short answer to your question is yes.

MR. MATELIS: Another predatory pricing question for -- I guess for you, Bruce Wark. You mentioned in your prepared remarks that you thought it was appropriate to acknowledge a meeting competition defense in the Section 2 context. I guess the flip side to -- or the argument against the meeting competition defense is that if it precludes liability in exactly those situations where, you know, a low-cost -- a lower cost new entrant might be seeking to enter, and a higher cost incumbent lowers cost. So in that instance the meeting competition defense would provide a safe harbor for sort of the core theory of how predatory pricing can work to harm competition.

Sort of in general give me your thoughts on why the meeting competition defense is appropriate and why my attempt to defend it might not be the right way to look at it.

MR. WARK: Well, I think from the perspective of the alleged preditee, they picked a point in the marketplace where they have to decide they're going to be successful. We didn't.

It is a different situation than when that cost is imposed on them. If I went out and imposed a cost on them that was below my measure of marginal or incremental costs with the intention of driving them out, and they couldn't survive at that price, then that would be a different situation than when you have the alleged victim setting the price in the marketplace.

If they raise their price and we didn't follow, that might be a different fact. But I think that if a competitor that basically sets its own price in the market can't survive, it's not the kind of efficient competitor that the competition laws are intended to protect.

MR. MATELIS: Do you have any thoughts on how easy or hard it is to compare costs when you're seeking to apply the meeting competition defense? Is the cost comparative always intuitive, or are there hidden costs that make that comparison difficult?

MR. WARK: Well, I guess what I'm arguing is that the defense, you don't have to worry about my costs. I ought to be able to compete for every passenger I can at the price determined by my competitor.

MS. GRIMM: I think those are all the questions that Joe and I have.

I would like to ask our panelists if they have any additional questions or observations they'd like to make.

MR. WARK: Just to simply extend my thanks again for the opportunity.

MS. GRIMM: And I'd like to thank all of you for joining us here today. The weather is very challenging, and we really appreciate your taking time off from your very busy schedules to be with us and prepare for these hearings. Your remarks have been very insightful, and we appreciate your sharing your views with us. Can we all give them a hand of applause?

(Applause)

MS. GRIMM: Thank you all and have a safe trip home.

(Which were all the proceedings had in the above-entitled cause this date and time.)

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I, PAMELA STAFFORD, Certified Shorthand Reporter for the State of Illinois, do hereby certify that the foregoing was reported by stenographic and mechanical means, which matter was held on the date, and at the time and place set out on the title page hereof and that the foregoing constitutes a true and accurate transcript of same.

I further certify that I am not related to any of the parties, nor am I an employee of or related to any of the attorneys representing the parties, and I have no financial interest in the outcome of this matter.

I have hereunder subscribed my hand on the day of , .

PAMELA STAFFORD, CSR