

Refusals to Deal with Rivals: A Proposed Synthesis

William Kolasky

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Overview

- Pre-*Trinko* refusal to deal law
- *Trinko*
- Contending standards
- A proposed synthesis: A Section 2 rule of reason
- Application to refusals to deal with rivals

Pre-Trinko Refusal To Deal Law



Pre-*Trinko* Refusal To Deal Lines of Cases

- Vertical integration
- Essential facilities
- Intellectual property
- *Aspen*



Vertical Integration

- Long line of cases, many involving refusals to deal by monopoly newspapers vertically integrating into distribution
 - Virtually all decided in favor of monopolist
- *Paschall v. Kansas City Star* is illustrative
 - Eighth Circuit, sitting en banc, applied Section 1 rule of reason standard to uphold refusal to deal
 - Court found that anticompetitive effects from alleged loss of potential competition were slight
 - Court found that defendant had proffered several legitimate business reasons, including greater responsiveness to subscribers and more uniform pricing to facilitate advertising
 - Court held that, on balance, plaintiffs had not carried burden of showing that procompetitive effects were outweighed by anticompetitive effects



Essential Facilities

■ *Otter Tail*

- 4-3 decision, with opinion by Justice Douglas
- Involved range of anticompetitive acts designed to prevent communities from replacing its retail electric power franchise with municipal distribution system
- Acts included refusal to sell wholesale power to proposed municipal systems or to allow electricity produced by others to flow through its transmission lines

■ *MCI v. AT&T*

- Involved range of anticompetitive actions designed to stifle long-distance competition, including dragging out negotiations over interconnection terms
- Seventh Circuit articulated four-part “essential facilities” test
 - (1) control of essential facility
 - (2) inability to duplicate facility
 - (3) denial of use on reasonable terms
 - (4) feasibility to make facility available



Refusals to License IP Rights

- *Data General*

- “while exclusionary conduct can include a monopolist’s unilateral refusal to license a copyright, an author’s desire to exclude others from use of its copyrighted work is a presumptively valid business justification for any immediate harm to consumers.”

- *Kodak v. Image Technical Services*

- Endorsed *Data General* presumption, but held that presumption could be overcome by showing that the proffered justification was pretextual

- *CSU v. Xerox*

- “In absence of any indication of illegal tying, fraud in the [PTO], or sham litigation, the patent holder may enforce the statutory right to exclude others from making, using, or selling the claimed invention free from liability under the antitrust laws.”



Aspen: What Standard?

- Jury Instruction:
 - “a company which possess monopoly power and . . . which refuses to deal with a competitor in some manner does not violate Section 2 if valid business reasons exist for that refusal”
- Court’s amplification
 - “[W]hether Ski Co.’s conduct may properly be characterized as exclusionary cannot be answered simply by considering its effect on Highlands. In addition, it is relevant to consider its impact on consumers and whether it has impaired competition in an unnecessarily restrictive way.”
 - “If a firm has been ‘attempting to exclude rivals on some basis other than efficiency,’ it is fair to characterize its behavior as predatory.”



Aspen: The Conduct at Issue

- Ski Co.'s conduct was anticompetitive because it impaired Highlands' ability to compete *and* deprived consumers of desirable multi-mountain pass
 - Discontinuation of 4-mountain pass
 - Refusal to accept Highlands' vouchers
 - Discontinuation of 3-day, 3-mountain pass
- Ski Co.'s proffered justifications were pretextual
 - Difficulty of monitoring usage
 - Administrative burden
 - Disassociation with Highlands' inferior skiing services
 - Didn't discuss: Recapturing revenues siphoned off by Highlands



Trinko: Key Message Points

- No general duty to deal
- Compelled sharing disfavored
- Aspen at “outer boundary” of Section 2
- Reduced need for antitrust intervention when regulatory regime is in place whose objective is promotion of competition



Trinko: Compelled Sharing Disfavored

- Opportunity to charge monopoly prices induces risk-taking that produces innovation and economic growth
- Compelled sharing may lessen incentive for both monopolist and rival to invest in economically beneficial facilities
- Enforced sharing requires courts to regulate price, quantity and other terms of dealing, for which they are ill-suited
- Compelling negotiation between competitors may facilitate collusion



Trinko: Distinguishing Aspen

- “Unilateral termination of a voluntary (and thus presumably profitable) course of dealing suggested a willingness to forsake short-term profits to achieve an anticompetitive end.”
- “Unwillingness to renew ticket even if compensated at full retail price . . . suggest[ed] a calculation that its future monopoly retail price would be higher.”
- Ski Co. refused to provide rival a service or product that it was in the business of providing to customers generally



MetroNet I: Expansive Application

- Facts
 - Qwest offered large business customers who purchased 21 or more Centrex lines a substantial discount
 - Resellers emerged who took advantage of discount to offer Centrex service to customers who did not qualify for discount at reduced prices
 - Qwest imposed a per-location requirement to limit resale
- Ninth Circuit initially reversed summary judgment for plaintiffs
 - Held that Qwest conduct could be found exclusionary because it not only squeezed MetroNet out of the market but also raised prices to small business customers
 - Held that Qwest could be required under essential facilities doctrine to continue to offer Centrex features to MetroNet at discounted price that would allow MetroNet to resell Centrex services profitably



MetroNet II: Impact of Trinko

- On remand after *Trinko*, Ninth Circuit reversed itself and reinstated summary judgment for Qwest
 - Under *Trinko* plaintiff could not establish an essential facilities claim because the 1996 Act provides the WUTC with the effective power to compel Qwest to share its local exchange network with competitors.
 - MetroNet did not fall within the *Aspen Skiing* exception to the general “no duty to deal” rule.
 - Qwest imposed per-location requirement after it realized that resale of Centrex by resellers was having significantly negative impact on its own profitability
 - Qwest was willing to sell Centrex to MetroNet at its standard retail price
 - Elimination of arbitrage would not necessarily harm consumer welfare and there was a regulatory scheme in place that had been “attentive” to the issue and could act if necessary to protect the public interest

Contending Standards



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Contending Standards

- Section 2 Rule of Reason
- The profit sacrifice/no economic sense test
- The Essential facilities doctrine



Microsoft: Section 2 Rule of Reason

- To be condemned as exclusionary, conduct must have an “anticompetitive effect” – that is, “it must harm the competitive process and thereby harm consumers”
- Four-step test for exclusionary conduct
 - **First**, plaintiff must demonstrate that the monopolist’s conduct had the requisite anticompetitive effect
 - **Second**, if plaintiff successfully establishes *prima facie* case by demonstrating anticompetitive effect, monopolist may proffer “procompetitive justification” -- that is, “a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal”
 - **Third**, if defendant proffers a nonpretextual procompetitive justification, burden shifts back to plaintiffs to rebut that claim
 - **Fourth**, “if the monopolist’s procompetitive justification stands unrebutted, then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit”



Microsoft: Application of Rule of Reason

- License restrictions
 - Restrictions impaired competition by making it more difficult for OEMs to offer competing browsers
 - Court subjected Microsoft's copyright infringement justifications to close scrutiny
- Integration of IE and Windows
 - Court expressed general deference to dominant firm's product design decisions
 - Found that excluding IE from Add/Remove function and commingling browser and OS code would deter OEMs from installing second browser because doing so would increase product testing and support costs
 - Microsoft proffered no efficiency-related justification for these two product design decisions



Profit Sacrifice/No Economic Sense Test

- *Melamed*: “[C]onduct is anticompetitive if, but only if, it makes no business sense or is unprofitable but for the exclusion of rivals and resulting supracompetitive recoupment.”
- *Werden*: “If challenged conduct has a tendency to eliminate competition and would make no economic sense but for that tendency the conduct is exclusionary”



Essential Facilities Doctrine

- “America’s most successful export”
- “An epithet in need of limiting principles”

Proposed Synthesis: A Section 2 Rule of Reason



Four-step Rule of Reason Test for Exclusionary Conduct

- **First**, plaintiff must demonstrate that monopolist's conduct had requisite anticompetitive effect
- **Second**, if plaintiff successfully establishes *prima facie* case by demonstrating anticompetitive effect, monopolist may proffer "procompetitive justification" – that its conduct is a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal"
- **Third**, if defendant proffers a nonpretextual procompetitive justification, burden shifts back to plaintiffs to rebut that claim
- **Fourth**, if monopolist's procompetitive justification stands unrebutted, then plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit



The *California Dental* Sliding Scale

- “There is always something of a sliding scale in appraising reasonableness [T]he quality of proof required should vary with the circumstances.”
- “In applying the rule of reason, the courts, as in any balancing test, use a sliding scale to determine how much proof to require.”
- “What is required . . . is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint.”
 - The stronger the evidence of anticompetitive harm, the closer the scrutiny of the proffered justifications

Direct balancing of harms and benefits rarely necessary



First Amendment Standards of Review

- *Strict Scrutiny*: Government must show that law is necessary to achieve a compelling government interest and that the law uses the least restrictive means necessary to advance that interest
- *Intermediate Scrutiny*: Government must show that law is necessary to achieve a substantial governmental interest and that the law is narrowly tailored to that interest
- *Weak Scrutiny*: Government need only show a legitimate governmental interest and that the law is rationally related to that interest



Equal Protection Standards of Review

- *Strict Scrutiny*: If law disadvantages a “suspect class” or infringes a “fundamental right,” government must demonstrate that classification has been precisely tailored to serve a compelling governmental interest
- *Intermediate Scrutiny*: If classification, while not facially invidious, raises serious constitutional issues, classification must serve important governmental objectives and must be substantially related to the achievement of those objectives
- *Weak Scrutiny*: If law does not target suspect classes or fundamental interests, law will be sustained if the classification is rationally related to a legitimate state interest



Rule of Reason vs. Profit Sacrifice Test

- Rule of reason focuses directly on competitive effects, whereas profit sacrifice test focuses on effect on monopolist, not on competition
- Exclusionary conduct can be profitable, even in short term
- Profit sacrifice test doesn't acknowledge need to calibrate degree of scrutiny of business justifications based on strength of evidence of competitive injury
- No obvious reason why courts should be any less able to evaluate competitive injury and business justifications in Section 2 vs. Section 1 setting

Application of Section 2 Rule of Reason to Refusals to Deal



Core Principles

- In evaluating competitive effects, court should distinguish between a simple refusal to deal and a refusal that is part of a pattern of anticompetitive conduct
 - Simple refusal to deal will generally not restrict competition that would otherwise have existed
- In evaluating proffered justifications, court should take into account “macro-justifications” – namely, the desire to capture the value of one’s investments and innovations
 - Developing new facilities and inventions in order to gain competitive advantage is essence of competition on the merits
- Degree of scrutiny of proffered business justifications should depend on strength of showing of anticompetitive effect
 - Courts should not substitute their judgment for that of the monopolist as to business strategy
- Court should not impose any remedy it cannot enforce



Analogy to Tacit Collusion

- Interdependent behavior natural in oligopoly markets
- Prohibition on tacit collusion would not be administrable without ongoing judicial regulation
- Courts therefore require proof of “plus factors”

Same considerations apply to unilateral refusals to deal



The Essential Facilities Doctrine: A Dangerous Relic

- Allows imposition of liability on simple refusals to deal without taking sufficient account of incentive effects
- Imposes affirmative burden on monopolist to show that access is not feasible
- Requires courts to regulate terms of access



Should There Be A Special Rule of Intellectual Property?

- No reason to treat intellectual property differently from other forms of property
 - Property rights granted by patent laws no stronger than other forms of property
 - Justifications for not sharing are different, but equally strong for both types of property
- Once essential facilities doctrine is finally interred, need for a different standard disappears

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