Remarks of

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Unilateral Refusals to Deal

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Thank you for inviting me to appear today to talk about unilateral refusals to deal.

The antitrust agencies can have a positive impact on U.S. antitrust law – and can help promote the development of sensible global antitrust standards – by advocating that unconditional, unilateral refusals to deal with competitors[1] do not belong in the category of potentially exclusionary conduct that can violate Section 2. This should be the case regardless of whether the conduct involves intellectual property rights or tangible goods. It should be the case regardless of whether the property owner initially began dealing with a competitor and then stopped, or never dealt at all. Antitrust liability should not depend on the owner's reasons for not dealing with a competitor. Liability should not be imposed based on some calculation of whether the owner chose the right price at which to deal,

[1] These are the types of refusals to deal that I am discussing throughout these remarks, unless otherwise indicated. Refusals to deal that are conditioned on some other conduct can analyzed other areas of antitrust law. For example, a refusal to supply a product unless the purchaser buys a second product can be reviewed under a tying analysis, or a refusal to supply unless the purchaser deals only with the supplier would be a form of exclusive dealing.

or on whether the owner's products have applications in one market or many markets. A unilateral decision not to deal with competitors should be treated as the lawful exercise of whatever power is inherent in the product or technology in question, rather than the unlawful extension or maintenance of such power. Imposing a duty to deal with competitors reduces both the supplier's and the competitors' incentives to innovate. And it requires regulation of the seller's pricing, which, for compelling policy and practical reasons, antitrust law should avoid.

There have been some positive legal developments in the refusal to deal area, but businesses and their counselors continue to face uncertainty and potential liability based on ill-defined and arbitrary legal standards. This environment impedes legitimate business conduct and imposes unnecessary costs. The main risks are not of federal enforcement, which for good reason has been virtually nonexistent for many years, but of private litigation in the United States – private lawsuits continue to be filed in the aftermath of the Supreme Court's *Trinko* decision[2] – and of international enforcement. The agencies should use these hearings as an opportunity to shape the development of the law in both of these arenas. The courts are attentive to the agencies' views, and U.S. policies can affect how competition law develops in other countries. A key element of U.S. advocacy abroad has been the importance of avoiding the misuse of competition laws in ways that impair firms' incentives to invest and their ability to capture the return their investment. This advocacy is more credible

[2] Verizon Communications v. Law Offices of Curtis V. Trinko LLP, 540 U.S. 398 (U.S. 2004).

if our own policies avoid the same pitfalls that we criticize when we observe them in other countries.

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The Supreme Court's *Trinko* decision was an important step in the right direction for unilateral refusals to deal, but it left some unfinished business. The Court made clear that possessing market power, and exercising it by charging monopoly prices, is not only not unlawful but is "an important element of the free market system" because the ability to reap the returns on investment, innovation and risk are what spur those activities in the first place.[3] *Trinko* described *Aspen Skiing*[4] as a limited exception to the general right to refuse to deal that is "at or near the outer boundary of Section 2 liability," and noted that the Court has been "very cautious in recognizing such exceptions, because of the uncertain virtue of forced sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm."[5] Yet *Trinko* left the door open to Section 2 claims based on unilateral, unconditional refusals to deal with a competitor – as lower court decisions subsequent to *Trinko* have shown:

- *Trinko* gave strong support to the idea that there must be a termination of a voluntary course of dealing in order for a refusal to deal claim to be viable. This distinction, found in numerous cases before *Trinko* and followed in several post-*Trinko* decisions, is helpful insofar as it screens out some cases, but it still allows for liability when the supplier does begin

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3 *Id.*at 407.

4 Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985).

5 540 U.S. at 408.

supplying and then changes its approach toward competitors, which is not a principled basis for identifying potentially unlawful behavior.[6]

- *Trinko* perpetuated an unhelpful focus on intent, and on the presence or absence of business justifications, in refusal to deal cases. Lower courts have continued to do so as well.[7]
- *Trinko* cast doubt upon, but did not conclusively reject, the essential facilities doctrine.[8]

In the intellectual property area, a circuit split persists as to whether intellectual property owners face potential antitrust liability for unilaterally refusing to license their IP rights to others. In *Image Technical Services v. Kodak,* the Ninth Circuit held that Kodak's refusal to provide patented parts for its copiers to competing service providers unlawfully extended Kodak's monopoly in a parts market into a separate market for service. The Ninth Circuit held that while a

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[6] *See* American Central Eastern Texas Gas Co. v. Union Pacific Resources Group, 93 F. App'x 1 (5th Cir. 2004) (upholding arbitrator's finding of monopolization for refusal to deal in context of supplier's prior course of dealing); Nobody in Particular Presents, Inc. v. Clear Channel Communs. Inc., 311 F. Supp. 2d 1048 (D. Colo. 2004) (denying defendant's motion for summary judgment on refusal to deal claim where defendant had reversed prior course of dealing); A.I.B. Express, Inc. v. FEDEX Corp., 358 F. Supp. 2d 239 (S.D.N.Y. 2004) (denying defendant's motion for judgment on the pleadings on refusal to deal claim where defendant changed course by reducing discounts); *see also, e.g.,* Covad Communs. Co. v. Bell Atlantic Corp., 398 F.3d 666, 673 (D.C. Cir. 2005) (concluding that a claim for refusing to deal with a competitor can withstand dismissal "only when it is alleged either that the defendant had previously 'engaged in a course of dealing with its rivals, or [that it] would ever have done so absent statutory compulsion'") (*quoting Trinko*, 540 U.S. at 409); Covad Communs. Co. v. Bellsouth Corp., 374 F.3d 1044 (11th Cir. 2004) (rejecting refusal to deal claim based in part on conclusion that "*Trinko* now effectively makes the unilateral termination of a voluntary course of dealing a requirement for a valid refusal-to-deal claim under [Aspen Skiing]," 374 F.3d at 1049); Metronet Services Corp. v. Qwest Corp., 383 F.3d 1124 (9th Cir. 2004) (change in pricing structure did not, as a matter of fact, amount to termination of prior course of dealing).

[7] *See, e.g.,* American Central Eastern Texas Gas Co., n.6 *supra* (no valid business justification found for refusal); Metronet Services Corp. v. Qwest Corp., n.6 *supra* (no evidence that defendant's conduct was "prompted not by competitive zeal but by anticompetitive malice," 383 F.3d at 1132 (*quoting* Trinko).

[8] The Court implicitly criticized the doctrine, noting that its conclusion "would be unchanged even if we considered to be established law the 'essential facilities' doctrine crafted by some lower courts," but the Court "found no need either to recognize it or to repudiate it here." 540 U.S. at 410-11.

patent holder's exercise of its patent rights is a presumptively valid business justification for a refusal to license, the presumption may be rebutted by evidence of "pretext."[9] The Federal Circuit rejected the *Kodak* analysis in *Xerox*, concluding that a patent holder's motivations for refusing to license are irrelevant.[10] Nonetheless, patent holders that can be sued in the Ninth Circuit must pay attention to the *Kodak* analysis in deciding how to deploy their IP rights.

The proper approach to refusals to deal would not distinguish between intellectual property and other forms of property, but would treat all unilateral, unconditional refusals to sell or license as outside the scope of conduct that can be viewed as exclusionary under Section 2. This unified approach would put the law regarding refusals to deal in non-intellectual property in line with *Xerox* and other pre-*Kodak* cases that view unconditional refusals to license IP rights as categorically lawful, and would be consistent with the *Intellectual Property Guidelines'* policy that the same general antitrust principles should apply to conduct involving intellectual property and other forms of property.[11]

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Businesses and their counselors can and do find ways to minimize antitrust risk in the refusals to deal area and still pursue a wide range of legitimate activities. But innovation and efficiency would be promoted by the

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[9] 125 F.3d 1195, 1219 (1997).

[10] *In Re Independent Service Organizations Antitrust Litigation*, 203 F.3d 1322, 1327-28 (Fed. Cir. 2000), *cert. denied*, 531 U.S. 1143 (2001).

[11] U.S. Department of Justice & Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual Property, Section 2.1 (1995).

removal of any prospect for antitrust liability from a firm's decision to retain all the return on its investment in products or technology.

I described the counseling issues that arise in this area when I spoke about refusals to license intellectual property at the FTC/DOJ hearings on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy.[12] That discussion focused on refusals to license IP rights rather than refusals to deal more broadly, but my main points then apply to the current discussion.

Consider the issues facing a hypothetical firm that has developed a product that offers substantial improvements over existing products. Some aspects of the innovation are patented while others are not. Some applications for the product are obvious, while others are unknown and will only be revealed over time. The product may require replacement parts and service, for which the innovator initially is the only provider. The supplier may face uncertainty in pricing the product at the outset, given the lack of a track record for the product's performance and the variety of potential applications. Various types of competitors may want access to the product or to parts, whether to become a pure reseller, to use the product as an input into another product, or to develop a competing parts and service business. The firm's product development and marketing personnel may or may not have the benefit of antitrust counseling, and they may express their objectives in many different ways in their internal

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[12] Statement of Mark D. Whitener (May 2, 2002), *available at* *http://www.ftc.gov/opp/intellect/020501whitener.pdf*.

communications, but however they express it, all are motivated by a common goal: to maximize the return on the firm's investment in the product.

Under current law the firm may need to consider several issues. If the product turns out to be highly successful in some application, a claim of market power might be made that is at least sufficient to survive dismissal. Does the firm then need to worry about refusing rivals' requests to purchase the product or its parts? Does it matter whether the product in question is IP-protected? If the firm is advised that it may be more exposed to potential antitrust liability once it begins a voluntary course of dealing with a competitor and then terminates it, then is the firm better off not dealing at all, even though it might have decided to deal if it had the legal flexibility to change course later should circumstances (or the firm's understanding of the circumstances) change? What if the firm started selling to competitors and only later realized that it would make more money if it kept to itself all sales to end-users in all applications? Finally, if a decision to deal with competitors is made in this hypothetical, what price should the supplier offer? Is there risk of liability if the firm grants its best discounts to its end-user customers while charging more to competitors? Or if it charges an amount that fully compensates the firm for all lost sales and any impact on margins that might result from dealing with competitors?

Ideally, the firm's unilateral, unconditional decisions about whether to deal with competitors, or at what price, should not raise antitrust considerations at all. The various distinctions that are drawn in the cases – intellectual vs. non-intellectual property, termination of dealing vs. no dealing at all, "competitive zeal" vs. "anticompetitive malice" – all fail to distinguish between pro-competitive and anticompetitive conduct, and fail to provide any basis for requiring property owners to deal with competitors.

As a practical matter, the outcome of the above hypothetical may depend on how business personnel expressed their objectives in writing. We need to bear in mind that when it comes to deciding how to deploy a product, the bottom line is always … the bottom line: how to maximize profits. The identical objective can be stated in many different ways, but fundamentally it remains the same. The legal treatment of a decision whether to deal with a competitor should not depend on whether that objective is stated in a way that is appealing to an antitrust lawyer's ears (maximizing returns on investment, protecting IP rights, promoting sales to end-users customers) or is stated less artfully (obtaining higher prices/margins, preventing others from using the product to compete with the supplier). Antitrust liability should not turn on how property owners express their lawful intention to retain exclusive access to their own property.

In assessing these issues, prudent business leaders and their counselors need to take into account practical factors such as type of forum in which the issues will be assessed, and the legal standards that will be applied. Again, the main risk in this area is not U.S. government enforcement but private litigation, and this is where the post-*Trinko* refusal to deal cases and decisions like the Ninth Circuit's in *Kodak* come into play. In the above hypothetical, the firm's ability to obtain dismissal of a competitor's monopolization claim based on a refusal to deal may depend on essentially arbitrary factors such as whether it began dealing and stopped, or how it expressed its profit-maximizing objectives in its documents. The situation is even less satisfactory if the case gets to a jury. The challenges with trying complex antitrust cases before juries are not confined to refusals to deal, of course, but this is an area where even the ABA's model jury instructions illustrate the incoherence of the legal standards.[13]

Any resources consumed in counseling, investigating or litigating these issues are resources poorly spent. Branding a practice a "refusal to deal" is, in the context of a unilateral, unconditional act, simply another way of describing a decision unilaterally to retain and exploit one's own property rights. It is not "exclusionary" in the manner of conditional practices or agreements that actually diminish competitors' ability to constrain the incumbent *using the rivals' own capabilities,* as opposed to simply not sharing capabilities that were lawfully (as we assume in these cases – otherwise, there may be an independent basis for Section 2 liability) obtained by the incumbent.

[13] "A refusal to deal with a competitor constitutes anticompetitive conduct only where the refusal is contrary to the short-run best interest of defendant, and where it makes sense for defendant only because it harms competitors and helps defendant achieve or maintain monopoly power in the long run … A refusal to deal that is designed to protect or further the legitimate business purposes of defendant does not violate the antitrust laws, even if that refusal injures competitors. In general, the desire to maintain monopoly power or to block entry of competitors is not a legitimate business purpose … Thus, a refusal to deal that harms defendant's independent interests and makes sense only to obtain or maintain monopoly power is not based on legitimate business purposes." American Bar Association, Model Jury Instructions in Civil Antitrust Cases, Sherman Act Section 2, Monopolization, Instruction 2: Unilateral Refusal to Deal with a Competitor, and Instruction 3: Unilateral Refusal – Legitimate Business Purpose (2005). Under these instructions, a jury arguably is directed find for the plaintiff if, for example, a monopolist decided to forego profits in the current quarter from training potential competitors to service the monopolist's equipment, in order to preserve future service profits that would be undermined once the competitor established a service business based on that training. A key issue might be whether the jury would view the decision not to train competitors as one that "further[s] the legitimate business purposes of defendant" or one that "blocks entry of competitors" (Instruction 3), a distinction for which the model instructions – in line with the case law – provide little guidance.

Imposing a duty to deal with competitors also requires a determination of the price at which the supplier must deal – otherwise, the supplier can effectively refuse to deal by charging a high enough price. There are many reasons why this sort of price regulation, and imposing a duty deal that necessitates it, are bad ideas. Doctrinally, as *Trinko* made clear, U.S. antitrust law does not prohibit the possession of monopoly power or its exercise by charging monopoly prices. There is no legitimate policy or legal basis for distinguishing between charging the monopoly price for the monopoly good and refusing to supply that good to rivals. Nor is there any basis for permitting the monopolist to charge the monopoly price in one market or application for the product, while regulating its ability to charge the price that captures the product's entire value, regardless of the number of applications or levels of production in which the product may have value. Practically, of course, there are enormous difficulties inherent in any such price-regulatory regime, notably the courts' and enforcers' inability to implement any given price-regulatory model with any degree of consistency, accuracy or efficiency.[14]

In addition, the more valuable a particular innovation is – or put another way, the more worthy of protection is the investment in that innovation – the more likely rivals are to desire access. At the same time, in the case of innovations that actually create market power, competing innovation by rivals is all the more valuable as a means of constraining that market power. Yet rivals' incentives to

[14] The resources required to implement price regulation in support of a duty to deal would likely dramatically increase if, as some have proposed, the law on refusals to deal were to move toward a more stringent standard compelling firms with arguable market power to deal with all comers. This would in effect subject many firms to regulation of all their pricing decisions, including, for example, perfectly rational (and profit-maximizing) decisions to offer their best prices to their primary, end-user customers.

innovate are undermined to the extent they can use the antitrust laws to require the original innovator to share part of the return on its investment.

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The virtues of a clear statement by the Federal Trade Commission and the Department of Justice that unilateral, unconditional refusals to deal are not exclusionary practices under Section 2 would go beyond the promotion of sensible antitrust policy in the United States. Competition laws exist in many countries, with more on the way, and enforcement policies being developed or revised in many jurisdictions. The U.S. antitrust agencies are important advocates for sensible development of global competition policies, whether in the context of the European Union's review of Article 82 or China's development of a comprehensive anti-monopoly law. This advocacy is the most effective when it is consistent with U.S. practice. When we see the specter of an essential facilities doctrine or a broad duty to deal in drafts of the Chinese antimonopoly law, for example, we are quick to point out how this could chill investment and innovation, lead to price regulation, and fail to serve the interests of consumers. We should not be timid about eradicating the vestiges of these sorts of policies in our own law.

Finally, the approach I suggest today is consistent with the underlying principles that the agencies' leaders articulated for these hearings.[15] The

[15] Remarks of Deborah Platt Majoras, Chairman, Federal Trade Commission, The Consumer Reigns: Using Section 2 to Ensure a "Competitive Kingdom," Opening Session, Hearings on Section 2 of the Sherman Act, at 9-10 (June 20, 2006); Thomas O. Barnett, The Gales of Creative Destruction: The Need for Clear and Objective Standards for Enforcing Section 2 of the Sherman Act, Opening Remarks for the Antitrust Division and Federal Trade Commission Hearings Regarding Section 2 of the Sherman Act, at 16-17 (June 20, 2006).

Chairman and Assistant Attorney General emphasized the importance of Section 2 standards that identify practices with demonstrable anticompetitive effects, do not deter innovation or other procompetitive activities, can be clearly stated and understood, and can be administered efficiently and effectively. Unilateral, unconditional refusals to deal with competitors fail these tests.

Again, I appreciate the opportunity to participate in these hearings, and I look forward to our discussion.