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and

UNITED STATES DEPARTMENT OF JUSTICE

SHERMAN ACT SECTION 2 JOINT HEARING

REFUSALS TO DEAL PANEL

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C O N T E N T S

P R O C E E D I N G S

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MR. ABBOTT: Good afternoon. I'm Alden Abbott, Associate Director of the Bureau of Competition of the Federal Trade Commission. I wish to join my co-moderator, Deputy Assistant Attorney General for Antitrust, Bruce McDonald, to welcome you to today's session of the FTC/Justice Department hearings on the antitrust implications of single firm conduct.

This is the fourth session in the ongoing hearings. Prior sessions involved an introductory overview of the topic, and sessions on predatory pricing and buying.

Before we start, I need to cover a few housekeeping matters. First, please turn off cell phones, Blackberries and any other electronic devices. Second, and most important, the restrooms are outside the double doors and across the lobby. There are signs to guide you. Third, in the unlikely event building alarms go off, please proceed calmly and quickly as instructed. If we must leave the building, go out the New Jersey Avenue entrance by the guard's desk, follow the crowd of FTC employees to a gathering point and await further instruction. Finally, we request you not make comments or ask questions during the session.

Thank you.

Now, before turning the podium over to my colleague, Bruce McDonald, I'll briefly mention, prior to giving more fullsome introductions, we're honored to have six of the most distinguished leading lights of antitrust here today. Bill Kolasky, Wilmer Cutler & Pickering, former deputy assistant Attorney General; professor and former dean and FTC chairman Robert Pitofsky of Georgetown University Law Center, and Arnold & Porter; Hew Pate, former assistant Attorney General and currently partner at Hunton & Williams; Professor Steven Salop, Georgetown University Law Center, Consultant CRA International, and also an FTC alumnus; Thomas Walton, director economic policy analysis, General Motors Corporation, and also an FTC alumnus; and Mark Whitener, senior counsel, competition law and policy, General Electric Company, and also an FTC alumnus. So we see there's a certain FTC flavor to the distinguished speakers here today, but I won't say anything more about that.

Bruce?

MR. McDONALD: If counting, there is a distinct DOJ flavor on the panel, too. Let me say my welcome to the joint DOJ/FTC single firm conduct hearings. The hearings opened on June 20 with an overview of the

issues presented by single firm conduct and the enforcement of Sherman Act Section 2. At the opening hearings, both FTC Chairman Debbie Majoras and antitrust AAG Tom Barnett emphasized the challenges in identifying what conduct threatens long-term harm to competition and the importance of developing clear rules to guide business and that both underdeterrence and overenforcement need to be considered.

Today is our fourth session, and our third day of hearings. Our topic today is refusals to deal, which is hard fought ground in the single firm conduct debate. Our distinguished panel will focus on the circumstances in which a firm's unilateral refusal to deal with a competitor violates or should or should not violate Section 2, addressing issues raised by Colgate, Otter Tail, Kodak, Aspen, Microsoft and Trinko. The views of our panelists have been influential in this debate, and we appreciate the time that they have devoted to these hearings.

Let me outline the agenda for you this afternoon. Each of the panelists will take about 15 minutes to outline the issues and things critical, then we'll take a 15-minute break, and then we'll dig deeper into a discussion, giving the panelists an opportunity to respond to each other's presentations and to consider

several propositions and hypotheticals that we hope will initiate further discussion. The hearing will end at about 5:00.

Let me turn the podium back to Alden Abbott to introduce the presenters. Thank you.

MR. ABBOTT: Thank you, Bruce. Our first speaker, Bill Kolasky, is cochair of Wilmer Hale Cutler & Pickering, actually Wilmer Cutler Pickering Hale & Dorr, it's a problem with all of these law firm mergers. He co-chairs the firm's antitrust and competition practice group. He's also had a distinguished record of public service. From September 2001 through December 2002, he served as Deputy Assistant Attorney General for International Antitrust at the Justice Department, at which time he spoke out vociferously on the benefits of an economic approach to antitrust in the international forum and was very active in helping launch the International Competition Network. His private practice covers a full range of antitrust matters and Bill has also taught antitrust law at American University, and he speaks regularly on antitrust topics.

Bill?

MR. KOLASKY: Thank you very much, Alden, and thank you, Bruce, as well, for inviting me to participate in this. I have to say that it's somewhat

intimidating to be the first speaker in this afternoon's session, especially given that I think all of the other members of the panel, and probably most of you in the audience, have thought longer and harder about these issues than I have.

The other disadvantage of speaking first, of course, is that everyone gets the chance to shoot at what I'm about to say. I do think that I have, perhaps, one comparative advantage, and only one, I'm going to try to take full advantage of that, and that is my age, and therefore, in fact, I've been doing this a lot longer than most of the people in the room.

I've titled my talk refusals to deal with rivals, because I want to distinguish very clearly between refusals to deal with competitors as opposed to refusals to deal with customers.

Refusals to deal with customers, I think involve very different competitive concerns. The exclusionary effects are more likely to be direct and immediate, and there's a long line of cases running from Lorain Journal to Dentsply that deal with refusals to deal with customers. As I understand it, we're not here to discuss those, we're here today to discuss refusals to deal with rivals.

In structuring my remarks, I felt that I made

one of the classic rookie mistakes, I have far too many slides and so I'm going to have to skip around somewhat, but I wanted to touch on five basic topics. The first is the pre-Trinko refusal to deal cases. Next I want to talk briefly about Trinko. Then I want to talk about the current dialogue that is going on, among others, between Steve Salop and my partner, Doug Melamed over the various standards for applying Section 2 generally. I then want to stake out my own position as to what analytical framework I think should be applied to Section 2, and it's basically a step-wise rule reason approach, applying the California Dental sliding scale. And then I propose to talk about how they apply to refusals to deal with rivals.

Focusing first on the pre-Trinko refusal to deal law, there are basically, I think, four distinct lines of cases. The first line of cases, and the oldest, are the vertical integration cases from the 1970s and early 80s. The second line of cases are the essential facilities cases, largely from the 1980s and early 1990s. The third line of cases are the intellectual property cases, most recently the Federal Circuit's decision in CSU. And then finally there is Aspen, which because it's a Supreme Court case, I think deserves particular mention and focus.

In the debate over refusals to deal, I've been surprised in the recent publications how little attention has been paid to the vertical integration cases, which is really where a lot of the law in this area was first developed. And when you go back and read those cases, I believe, at least, that the analytical framework that they used is a surprisingly sound one, given that these cases were decided largely in the 1970s and early 80s as we were just emerging from what Doug Ginsburg refers to as the dark ages of antitrust.

Many of the cases, some of which my firm was involved in, involved refusals to deal by monopoly newspapers that were vertically integrating into distribution. The obvious reason why these papers were vertically integrating into distribution was to get around the problem that was created by Albrecht, by the rule that maximum resale price by principles is per se unlawful. Since it was obviously efficient to have a single delivery person covering each block, newspapers found themselves basically with the situation where they were dealing with independent dealers, giving those dealers a monopoly, and they had no way to prevent those dealers from charging monopoly prices higher than what the newspaper itself would have charged.

It's not surprising, therefore, that the cases

for the most part ended up with the courts ruling in favor of the newspapers and upholding their refusal to continue to deal with independent dealers and vertically integrating into the distribution themselves.

When you go back and read the cases, and most notable the Paschall versus Kansas City Star decision, in 1984, which was an en banc decision of the Eighth Circuit, what you find is that the courts applied essentially a Section 1 rule of reason standard in evaluating these unilateral refusals to deal. In that sense, I would argue that they are in a way ahead of their time, because it was really not until the Microsoft decision in 2001 that a court of appeals here in the D.C. Circuit affirmatively embraced the rule of reason as the applicable standard for Section 2.

Applying that Section 1 rule of reason framework, the Eighth Circuit found that the anticompetitive effects from the alleged loss of potential competition as claimed by the plaintiffs were slight, and that the newspaper had offered several legitimate business reasons for its decision to vertically integrate into distribution.

One of the most interesting things about the case is that the newspaper did not rely on the argument that I relied on in my opening remarks about this case,

namely the need to get around Albrecht. Instead, the newspaper focused on the desire to be more responsive to subscribers and have more uniform pricing in order to facilitate advertising.

Quite frankly, those are relatively weak justifications for what the newspaper was doing, and yet nevertheless the court held without scrutinizing those justifications very closely, that they outweighed the rather minimal showing of anticompetitive injury that the plaintiffs had made.

One of the key factors in causing the court to reach that decision was its determination -- and this is consistent with what I said earlier on Albrecht -- that a vertically integrated newspaper was likely to charge lower prices than if you had unintegrated monopolists at both the publication level and the distribution level.

The essential facilities cases, I'm going to skip over lightly, because others are going to be speaking about those in more detail. There are two things that I want to note about them. The mother of essential facilities cases, at least with respect to unilateral conduct, is of course the Supreme Court's decision, Otter Tail. What people often don't comment on is that that was a decision in the mid-1970s, again, as we were just emerging from the dark ages, it was a

four to three opinion written by Justice Douglas, who probably wrote more decisions that antitrust lawyers now try to distance themselves from than almost any other Justice.

The other thing that's important about the key essential facilities cases such as Otter Tail and the Seventh Circuit's decision in MCI v. AT&T is that these cases do not involve just a simple refusal to deal by a monopolist. Rather, they were cases in which the monopolist had engaged in a whole pattern of conduct that was designed to exclude rivals from these monopoly markets.

The next line of cases, as I mentioned, are the cases involving intellectual property rights, the First Circuit's decision in Data General, the Ninth Circuit's decision in Kodak and the Federal Circuit's decision in CSU. There's been an enormous amount of ink spilled about these decisions, including a very good article by Hew Pate, and I'm sure Hew will have something to say about this line of cases.

The important point, I think, that one draws from these line of cases is the Second Circuit's recognition, which was endorsed even by the Ninth Circuit, that an author's or inventor's desire to exclude others from the use of copyrighted or patented

work is a presumptively valid business justification for any immediate harm to consumers that might result from a refusal to license.

The debate really, then, is between the Ninth Circuit and the Federal Circuit under what's necessary to rebut that presumption, with the Federal Circuit taking probably the most restrictive view that the presumption is virtually irrebuttable unless there is additional conduct beyond just the simple refusal to license, such as an illegal tie, fraud on the Patent & Trademark Office, or sham litigation. And I think that is consistent, in fact, with cases like MCI and Otter Tail, if you go back and read those decisions.

That brings me to Aspen Ski, which was the first serious effort, I would argue, by the Supreme Court to deal with the question of what standards should apply to refusals by monopolists to deal with its rivals, and the key points here that I want to bring out are that the Court focused not just on the impact on the rival, but also on the impact of the refusal on consumers, and the Court also made it clear that what it was looking at under Section 2 was whether the defendant was seeking to exclude rivals on some basis other than efficiency, that is other than through competition on the merits. And I think that's a very important strand that needs to be

kept in mind as one thinks about these cases.

The other point that's important to make about Aspen requires really looking at the facts of the case and what the conduct was. Again, as in Otter Tail and MCI, the conduct was not a simple refusal to deal. There was a lot of other conduct going on there, including to me most significantly the fact that Ski Co. discontinued its own three-day, three mountain pass so that the only way somebody could get a discount on a multi-day, multi-mountain pass was to buy a six-day pass, and that meant that if the vacationer wanted to ski the Highlands, they almost certainly had to pay twice, both for the day ticket to the Highlands and the six-day pass to the Highlands. The other thing that's important is that, while the court described Ski Co.'s justification as pretextual, the court also gave fairly close scrutiny to those justifications before reaching that conclusion.

Trinko, I'm not going to spend very much time on, because others are going to spend a lot of time on it. The key message point, of course, is that the Court appeared to adopt a very restrictive view as to when a monopolist might have a refusal to deal and cooperate with its rivals.

Because I'm running out of time, I'm going to

jump ahead to the contending standards. As I say, there are basically three sets of contending standards out there now, in this area. One is what I would call the Section 2 rule of reason approach, taken by the D.C. Circuit in Microsoft and by the Eighth Circuit in Paschall, the profit sacrifice or no economic sense test that Greg Werden from the Justice Department and Doug Melamed have been advocating and I think Hew from time to time has advocated it as well, and then finally the essential facilities doctrine.

Again, because we're running out of time, I'm going to skip ahead to my proposed synthesis. I come down, as I think about this, in favor of basically the Microsoft step-wise rule of reason test for exclusionary conduct. I think that test involves, as the court said, basically four steps. First, an examination of whether the monopolist's conduct, in this case its refusal to deal, had the requisite anticompetitive effect.

Second, a requirement that the monopolist, if the plaintiff establishes a prima facie case, proffer some nonpretextual procompetitive justification for its action, and if it does so, the burden then slides back to the plaintiffs to rebut that justification. And it's only if the plaintiff meets that burden that you move on to the fourth and final stage, which is balancing.

That's the reason why I don't particularly like to have this test described as the balancing test, because in fact, you rarely reach the fourth balancing step in the test.

In applying the step-wise rule of reason under Section 2, I would argue that the courts should do just as they do in Section 1, and as I believe they do in practice under Section 2, and that is apply a sliding scale. That is to say, as Justice Souter wrote in California Dental, what is required is an enquiry need for the case. In other words, the stronger the evidence of anticompetitive harm, the closer the scrutiny of proper justifications.

Going back to, I'm not sure how to go to a previous slide, I want to go back to Microsoft for a second, because -- I'm sorry about this. I hope I get a minute for my technological ineptitude. Here we go.

In Microsoft, if you read the decision closely, you will see that the court, in fact, applied exactly this kind of a sliding scale. When it came to the license restrictions that Microsoft imposed on OEMs, the court subjected Microsoft's proposed justifications to very close scrutiny. When it came, however, to the integration of Internet Explorer and Windows, the court expressed at the very outset of that section of its

opinion a general deference to the dominant firm's product design decisions, and the only reason it found Microsoft's conduct unlawful, to the extent it did, is that Microsoft proffered no justification whatever for its decisions.

What I found interesting, and I credit this to one of our summer associates, Tian Mayimin, who is in the audience today, is how similar the California Dental sliding scale approach to the rule of reason is to what the courts do in the constitutional area, both under the First Amendment, and under equal protection, where over the years, what began back in the 1960s as a balancing test, has evolved instead to three different levels of review, strict scrutiny, intermediate scrutiny, and weak scrutiny, in which the degree to which the court subjects the proffered justifications for the government's action depends on how objectionable the conduct is in terms of First Amendment principles and/or equal protection.

And I would suggest that the analogy in the antitrust area is to the test we use for determining whether or not the proper justifications justify the conduct at issue. We often talk about needing to find that the conduct is reasonably necessary, that's a relatively tough standard.

A more relaxed standard would be to find that it's reasonably related, and an even more relaxed standard would be that it's plausibly related, which is the standard the Supreme Court adopted in Broadcast Music in determining whether or not the per se rule should be applied. I would argue that you could use that same sliding scale under Section 2, where the degree of scrutiny depends on the nature of the conduct in question.

Why do I prefer the rule of reason approach to the profit sacrifice test? I think basically four simple reasons. One is that it focuses directly on competitive effects, whereas the profit sacrifice test focuses more on the effect on the monopolist, rather than the effect on consumers. Second, because, as Steve Salop has pointed out quite persuasively, exclusionary conduct can be profitable, even in the short-term, and in fact, if you read the facts of Aspen Ski, I suspect that even there, Aspen's conduct was profitable in the short-term, even though it degraded the attractiveness of its product to the skiers, and that's because it would have shifted skiers from Highlands to the Aspen mountains, thereby increasing its revenues, i.e., even if the total number of skiers coming to the Aspen area generally declined.

Third, at least as I have read the articles, the profit sacrifice test, as it has been articulated, doesn't acknowledge the need to calibrate the degree of scrutiny of the business justifications based on the strength of the evidence of competitive injury. Doug Melamed, for example, has argued that one can look at a refusal to deal as basically a make-or-buy decision, and that it should be unlawful if it would be more profitable for the monopolist to buy the downstream services than to vertically integrate them. I would argue that that is too high a degree of scrutiny for the courts to impose on those kinds of decisions.

And then finally, there is no obvious reason why courts should be any less able to evaluate competitive injury and business justifications in a Section 2 versus a Section 1 setting. What should differ is how strictly they scrutinize the justifications, not the test that they apply.

Thank you.

(Applause.)

MR. ABBOTT: Thank you, Bill. Now I have the honor of introducing Robert Pitofsky, a name known certainly to all of you and throughout the antitrust world, former FTC Chairman, Commissioner and Bureau of Consumer Protection Director, distinguished background

in private practice, currently of counsel at Arnold & Porter, and of course very distinguished academic, former NYU law professor, then dean of Georgetown Law School, currently Sheehy Professor in Antitrust and Trade Regulation Law at Georgetown University Law Center. His writings are many. He has co-authored, Cases and Materials on Trade Regulations, which is in its fifth edition, one of the most widely used antitrust and trade regulation case books.

Bob Pitofsky.

(Applause.)

MR. PITOFSKY: Thank you all and good afternoon. It's great to be back at the FTC, and to see that the DOJ and the FTC are continuing the tradition of taking on the toughest issues and addressing them not necessarily by litigation, but by hearings like this. And I do regard the definition of exclusion under Section 2, and refusals to deal in particular, as about the toughest issues that an antitrust lawyer is required to face today.

I'm going to do three things here. One, I want to put refusals to deal in a broader context, and I believe that's what Trinko's majority opinion was designed to do. Secondly, I want to say a little bit about the general universal test that Bill talked about

in such an interesting way. I just have one question, because I agree with virtually all that he had to say. And then I'm going to discuss, the antitrust concept of essential facilities and whether essential facilities is such an unwise doctrine that it ought to be abolished.

Let's start with Trinko, because I don't think Trinko is just about the facts of that particular case. It was a unanimous opinion. I would have voted to reverse the Second Circuit, too. I had no problem with the holding. It's the dicta in Trinko that went on and on and on, and I'm disappointed that other judges on the court didn't concur separately, and write that they were not ready to go along with all this additional talk. More broadly, I think Justice Scalia was saying, very directly, that he's uncomfortable, he's skeptical about enforcement of Section 2, and thinks that Section 2, certainly compared to Section 1 of the Sherman Act, causes more harm than good. His reasons were that there are too many false positives, as he put it, in Section 2, that Section 2 enforcement tends to chill the incentives of aggressive and innovative companies, that he's uncomfortable with a generalist antitrust court taking on issues like those raised by Section 2 enforcement, and the remedy, especially with refusal to deal, is at least difficult and may be impossible.

Let me just go through these. First of all, what is this false positives thing? I didn't agree with the Second Circuit either, but I didn't conclude that Section 2 raised many false positives as a result of that wrong decision. Is the meaning that lots of Section 2 cases have been brought by the government and private parties and have been thrown out on motions to dismiss, not stating a legitimate case? Well, let's go back and review the record: Lorain Journal, Walker Process, Otter Tail, Kodak, Xerox, Aspen, and Intel. The plaintiff won every one of those Section 2 cases. Now you might say yes, but they were false positives, Otter Tail should have been decided the other way. But the Supreme Court decided Otter Tail in favor of the plaintiff, and the Court has not subsequently overruled the decision.

Now there have been mistakes that have been made, but the idea that there's just constant false positives in Section 2 enforcement, I don't know where that's coming from.

Second, Section 2 enforcement chills incentives for innovative companies. I'm agnostic on that. Maybe that's true. Just show me the data. Show me anyone who has done a study which demonstrates that once a company is aware that it may have to engage in mandatory

licensing, at a reasonable royalty, they cut back on their investment in innovation. I haven't seen it. But I'm uncomfortable with all these ex cathedra statements that that would occur.

Third, uncomfortable because generalist antitrust judges are deciding these cases? Well, who are the judges deciding joint venture cases? Merger cases? Rule of reason cases? They all involve trade-offs, just like Section 2; they all involve generalist judges. Up until now, I thought U.S. antitrust was doing a pretty good job, and I'm not troubled that district judges are making a botch out of these trials.

On refusal to deal, if you mandate disclosure, you have not just the decision about mandating, you have a decision about at what royalty, what terms, what timing, and so forth. And there's no question, that complicates this issue immensely. It was worked out in Aspen Ski, it was worked out in Otter Tail, although there was a Federal Power Commission at the time Otter Tail was decided to help to work out the remedy. The question for me is, given the fact that the remedies in these cases are difficult, do you throw up your hands and say, impossible, therefore the monopolist can do anything it wants, or do you try to work out the best

remedy you can? Sometimes the remedy is easy. Perhaps the monopolist has already been licensing other people, but refuses to license potential competitors. It's not common, but it happens.

Sometimes the monopolist has been selling in other markets at a price it was comfortable with. That's the beginning of negotiation for this remedy. I grant immediately, it's difficult, the question is, does that mean free reign for the monopolist?

Second, on proposals for a general rule, first of all, I want to compliment Hew Pate, now Bill Kolasky, Steve Salop, Doug Melamed, Greg Werden, all of whom are trying to come up with a rule that lends certainty and predictability to Section 2 generally and refusals to deal specifically. But in the end, I think the balancing test as advocated in Aspen and Microsoft is where you have to end up. I'm uncomfortable with the universal rule that focuses on the welfare of the monopolist. That's the profit sacrifice test. I'm more concerned about the consumer, not whether the monopolist sacrificed profits.

On the approach that asks if there was any plausible economic reason for doing something, you know, I think lawyers can always come up with a plausible economic reason. That's not the issue. The issue is

whether that reason is good enough to outweigh the anticompetitive effects. And that, it seems to me, is what you have to do.

I would welcome a clearer rule, but in the end, you have to take into account the redeeming virtues, the business reasons, the justification, but if the anticompetitive effects are large and the efficiencies small, you can't stop with step one, you have to get to as many steps as you can, and that's the question that I would like to address to Bill. His third step is: what was your justification? Suppose the defendant states it, and then the other side comes in and let's say fails to show that your justification was not plausible, substantial, significant -- that is, there was some justification. Do we stop there? Or do we go on to the question of maybe you had a good justification, but it didn't outweigh the anticompetitive effects?

Let me return finally return to the issues relating to essential facilities. Let me start with the proposition that the general rule is and must be no general duty to deal. You don't have to disclose these kinds of information except under a very rare exception, and the exception is where a monopolist has a bottleneck monopoly. The scholars are suppose to all say let's get rid of the doctrine. That's really not what they say.

They say it should be rare and extremely narrow, that's Areeda, that's Hovenkamp. I say the same thing. It should be very rare, and very narrow.

But I think it should be an exception to the general rule. I think the best summary of the limitations on essential facility claims is in the MCI case, which I notice virtually every lower court that either sustains or overrules the essential facilities claim, they all use the MCI test. The test is as follows: one, it only applies to a monopolist; two, other potential rivals cannot duplicate the facility or the service. It's not just that it would be hard to duplicate it, it's they can't do it at all. Three, the monopolist denies access to the service or the facility; and four, that it's feasible to make use of the facility available.

I remember there was a throw-away line in Otter Tail, and that's not my favorite case in this area, but there's a throw-away line saying, you know, if you had said that there's an engineering reason why you couldn't wheel power to those municipalities, this would be a different case. The problem with Otter Tail is there was no plausible explanation except anticompetitive purpose for refusing to wheel the power.

The EU has added a few additional

qualifications: The refusal to deal must eliminate all competition, and that the product that the person seeking access would make is not just a clone of the first product, I don't think you need those two additional restrictions, although they do narrow the doctrine.

I think with the general qualifications stated in MCI, we're in good shape. And I do want to emphasize here -- the idea is not that the monopolist is giving anything away, it's receiving reasonable royalties that a court or an expert witness figured out was acceptable.

Finally, it has been said that there's Terminal Railways, there's Otter Tail, there's Associated Press, and there aren't many cases that address the essential facility issue. That's just not true. There are scores of lower court cases, including lower court cases since Trinko kicked a lot of mud on the essential facilities doctrine, which have addressed the claim of essential facilities.

Let me conclude by saying that while Section 2 enforcement is an area that deserves to be addressed, at least for the time being, I think Aspen Ski is the best approach to it. It applies a rule of reason, and the Court looked at and rejected any plausible business justification. It seems to me a monopolist ought to

have some reason for refusing to do business with a potential rival. I just don't think of antitrust as being so narrowly confined when it comes to the market power of a monopolist. I look forward to the discussion. Thank you.

(Applause.)

MR. ABBOTT: Well, so far we've heard one endorsement of the Cal Dental sliding scale approach and an endorsement of an approach based on Aspen Ski, variations on balancing approaches, and it will be interesting to see what our next speaker has to say about such approaches.

Hew Pate, partner and head of Hunton & Williams' Global Competition Practice Group, is a former Assistant Attorney General for antitrust, until relatively recently. Hew's practice involves all aspects of competition law, counseling and litigation. Hew has served as Ewald Distinguished Visiting Professor of Law at Virginia, from which he graduated first in his class. Hew clerked for two Supreme Court Justices, Justice Powell and Justice Kennedy.

Hew?

(Applause.)

MR. PATE: Thank you very much, Alden. It is great to be here at the Commission's conference facility

for these hearings. I appreciate the opportunity to take a part in them. I have submitted some written testimony, which I have prepared on behalf of the United States Telecom Association. That, as I understand it, will be available on the website for these hearings. As to my elaborations on that and what I say in the exchange, you've just got me, and all the views I express, both in the written testimony and here, are my own.

The general point of the testimony I'm going to give is that independent competition among competitors who are not relying upon one another for assistance or even for pulled punches in the competitive process is what best produces innovative products at low prices. Government-imposed duties to assist competitors force courts into setting prices, a task for which they are not very well equipped, particularly in capital intensive or high technology fields. The uncertainty that is caused by indeterminate liability rules and duties to assist competitors are likely to retard desirable investment.

And the U.S. system of private litigation, which uniquely puts decisions on these types of issues in the hands of general judges, as has been mentioned, and in the hands of juries, sometimes with very vague

instructions, exacerbates the problem. And I would suggest that recent experience in the telecommunications field provides a good illustration of this point.

This testimony, my testimony is first going to talk about refusals to deal and essential facilities. The question is where after Trinko these doctrines should go in the future, and my suggestion is not much of anywhere. These doctrines inherently generate uncertainty, they threaten returns on investment, and by doing so, they discourage investment from taking place.

With respect to refusals to deal, or as I prefer to think of it, duties to assist competitors, all have the right to take a different tack. I think in the wake of Trinko, as we have seen lower courts try to make sense of, and cabin the Aspen decision, that the time has come for Aspen to be overruled, and that the law would be better with it off the books, and that the Commission and the Division would do a service to the law by advocating that in their report from these hearings.

The second major point I want to make, while I don't at least in this presentation want to debate the variety of standards, as has been mentioned, I think the no economic sense test has a good deal to be commended. At the Antitrust Modernization Commission, I have

responded to some criticisms and made a general defense of that test, but for today, I simply want to suggest that the agencies would do a service by continuing to push for more objective standards in this area. And to my mind, while a general balancing test is flexible, because it can apply in a wide variety of circumstances, it is inherently lacking in any objective content that businesses can apply in a predictable manner to make their decisions. And while there may be different formulations of it, some variation of a price-cost comparison in my judgment is going to be necessary if objectivity is going to be brought to the inquiry.

With respect to the telecommunications industry experience, I think it does shed some light on whether duties with forced sharing are likely to produce desirable results. Telecommunications is an area where huge capital expenditures and great risk need to be undertaken to provide the product, and before any profits can be made. I had a good deal of experience in this industry in working on DOJ's implementation of the 1996 Act. And my experience there was that the DOJ staff worked tremendously hard to try to implement that act. But my experience in that process also left me convinced that forced sharing of assets with competitors is not a sound foundation for promoting competition.

As you all you are aware, the unbundling obligations of the 1996 Act were premised on a so-called stepping stone theory, the idea that if competitive local exchange providers were given mandated wholesale price access to incumbent local exchange providers' facilities, this would allow so-called CLACs to enter these markets officially without building facilities, without undergoing that inherent risk. This would bring immediate competition of a sort, and importantly, it would then allow CLACs to build their own facilities so that facility-based competition could follow thereafter.

A lot of water has gone under the bridge since the passage of that Act in attempts to administer it. I think the basic lessons are difficult to deny at this point. Rather than provide a stepping stone to independent competition, sharing obligations led to demands for ever greater and more complicated sharing obligations, many of which were found unlawful by the courts in ensuing litigation.

One writer who has actually supported forced sharing as a part of the antitrust laws recently summed it up this way: "The 1996 Act is arguably a good example of the questionable effectiveness of legally mandated sharing. After eight years, the FCC has failed to produce a legal system of access, and has instead

furthered a disastrous $50 billion Telecom boom and bust in local telecommunications."

The experience there, I would suggest, is illustrative of what happens when -- even when an agency, but when an agency and parties who can be protected want to litigate over the agency's rulings and what the forced sharing obligation will mean, I think provides an illustration of what is likely to ensue.

I think it also appears clear at this point that the Act's forced sharing obligation has in many instances slowed investment that otherwise would have been made. Bob asked, and other speakers wonder what is the empirical case for suggesting that incentives would be chilled. Among one collection of studies, I would point you to one by Scott Wallsten at the AEI-Brookings Joint Center For Regulatory Studies, which can be found on their website, and in summarizing the work in this area, he suggests that although there are a few dissenting voices, most economists and most studies conclude that unbundling obligations in the U.S. reduced incentives to invest in high-speed Internet infrastructure. Cable companies which weren't bound by these sort of unbundling obligations deployed more quickly. DSL has lagged behind cable in terms of deployment. That's the opposite situation we see in

many other countries.

The telecommunications industry recently has rebounded, perhaps not coincidentally, with a diminution of forced sharing obligations, and where reform of the 1996 Act is headed, is not entirely clear. But I do think that antitrust generally can learn some lessons from the experience, and the most important is that forced sharing discourages and slows innovation.

Second, I certainly do believe that the many complex and unforeseeable consequences of a forced sharing regime are extremely difficult to administer. It may be that in certain circumstances a regulatory framework can administer forced sharing obligations in some circumstances, or that a regulatory judgment will be made that it should, but as a general matter, as a general antitrust principle, and this is a point Justice Stewart made in his dissent in Otter Tail, the rare situations where that would be necessarily are not very easily translated into a general duty of antitrust to be applied across all industries. So, certainly in my judgment, the transaction costs that come with a broad sharing obligation are likely to outweigh the benefits.

Let me turn to refusals to deal and essential facilities under the antitrust laws. We've heard some comment about Trinko, and Aspen, already, and the three

rationales that the Court in Trinko offered for limiting, very severely, any duty to assist competitors. The Court did that in granting a motion to dismiss, holding that the plaintiff's claim in Trinko was so lacking in traditional antitrust merit that it does not even require discovery before dismissal of the case.

And the three rationales, as you know, were the negative incentive effects, both on the incumbent, the high-market share incumbent, and on potential new entrants from a sharing rule. Yes, skepticism of generalist courts and juries' ability to manage sharing obligations to set terms and prices. And then finally, this idea of false positives. I think false positives doesn't necessarily mean that we go to the Supreme Court or even to lower courts and figure out whether the defendants or the plaintiffs were winning, or whether cases were rightly decided, but it does require some consideration of the duties of those who are charged with risking capital and conducting business, about whether, in fact, their potential competitive activities are chilled by the fear of being embroiled in litigation under sharing duty types of rules, and for that reason, I think that the risk of false positives is significant.

As to Aspen, while I think Aspen, as I have said elsewhere, can be reconciled with a no economic sense

approach to the law and as consistent with it, since Trinko, a number of courts, and some commentators have come to view Aspen as standing for the proposition that once a course of sharing conduct begins, that it shouldn't be stopped. And if that's what Aspen is going to stand for, then I think we would all be better off if the case were overruled.

The reason for that, I think is pretty simple, that while it is a way to distinguish the fact pattern in Aspen from the fact pattern in Trinko, there's nothing in economics that would suggest that the facts are not likely to change in a pre-existing relationship. There's no particular reason to believe that a course of conduct that was once entered into remains efficient forever.

So, it may be true that a voluntary course of dealing provides an initial benchmark to set a price that presumably the parties wouldn't have entered into the relationship unless it were mutually profitable, all that's true, and mitigates to some extent the concerns that were in existence in Trinko, but it does not eliminate them.

The other serious problem I think with a duty of continued sharing is that it can prevent voluntary sharing from taking place in the first place. This is a

point Judge Posner made in the Olympia Equipment Leasing Company case, a case where Western Union had initially assisted Olympia, decided to stop, got sued for doing so, and as Judge Posner put it, if Western Union had known that it was undertaking a journey from which there could be no turning back, a journey it could not even interrupt momentarily, it would have been foolish to have embarked. And I think that's the real risk of a developing idea that Aspen stands for the proposition that you just can't stop sharing if you ever start.

Essential facilities, I won't spend too much time on. I certainly do not think it adds anything as a stand-alone theory of liability. I think Professors Areeda and Hoenkamp said it well, the doctrine is harmful because, I quote, "Forcing a firm to share its monopoly is inconsistent with antitrust basic goals for two reasons. First, consumers are no better off when a monopoly is shared. Ordinarily a price and output are the same as they were when one monopolist used the input alone. And second, the right to share monopoly discourages firms from developing their own alternative inputs."

I will conclude, and time is running out, simply by renewing a call for the agencies to participate in advocating more objective standards. I think we're at a

high water mark now of criticisms leveled at the standard-less nature of Section 2 generally. The OECD competition committee recently issued a background note that collects a number of these. I recall Elhauge has described the exclusionary conduct law that exists today as using a barrage of conclusory labels to cover for a lack of any well-defined -- for any well-defined criteria for sorting out desirable from undesirable conduct. Even Eleanor Fox, with whom I often disagree on panels like this, states that a number of the contemporary cases tend to be noncommittal and rely on obfuscatory language in their use of terms, such as anticompetitive.

So, I think uncertain legal and regulatory regimes, like limits on investment, are likely to prove strong deterrents to investment, and innovation. Certainly the continued reliance in some cases on intent is one example of the type of subjective standards that can lead to uncertainty and retard investment.

There is some positive sign, I think, on the horizon that the Supreme Court may continue to look into this area in the Weyerhaeuser case that they've granted recently, where liability was imposed on the basis of purchasing more saw logs than were needed. I would suggest that we're really not going to do very well in a

regime where juries make a determination based on what is right and wrong in log buying, without any more objective basis for decision.

I'll stop there. As to the empirical basis for all this, I would simply suggest that if the government is going to intervene, if it's going to decide to require sharing of a facility, if it's going to decide not to use a property rule for determining how assets are going to be used, but instead use a liability rule to take from the Doug Melamed paradigm from the famous law review article he authored with Judge Calabresi a long time ago, that it ought to have some pretty serious grounding for believing that the situation is going to be made better. I don't think right now that an empirical case can be made that forced sharing, that this aspect of antitrust used to assist competitors is going to leave consumers better off. I suggested some time before I left government that the Modernization Commission could do a study by trying to look into the empirical basis for different areas of antitrust. That's a hard thing to do, as they quickly decided, but without it, in an area where the economics don't produce a real consensus, I think the basis for government intervention is lacking.

Bob asked whether we should just throw up our

hands because it's so difficult. Emil Paulis, who works at the European Commission, used to make the same comment after he heard me speak, and he would always say, well, Hew, you just want to throw the baby out with the bath water, because the standards are so difficult. And I always would respond by saying, well, Emil, if I've got a baby, and I've got to dip it into some bath water, I would like to have some reason to believe that the baby is going to be cleaner after I take it out than it was before I put it in. And I don't think in this area of the law that we have that.

Thanks, I look forward to the discussion.

(Applause.)

MR. ABBOTT: The people who are standing in the back, there are some seats up front, so don't be shy, there are seats. Thanks, Hew.

So, now we have two rational balancers and one antitrust skeptic, and now we're going to turn to our first academically trained economist on the panel, Steve Salop, professor of economics and law at Georgetown University Law Center, where he teaches antitrust law and economics, economic reasoning for lawyers, and in addition maintains an active consulting practice at CRA International. Steve is no stranger to government, having worked at the Civil Aeronautics Board, the

Federal Reserve Board and the Federal Trade Commission. Now I remember him giving tutorials to young staffers on economics at the FTC, young bright staffers, I was one of them. And he did a very impressive job in that regard. Steve has written widely in leading antitrust journals, on this topic of Section 2, and I, for one, look forward eagerly to hear his comments.

Steve?

(Applause.)

MR. SALOP: Thank you. I'm really pleased to be here. I'm thrilled that Bill Kolasky seems to agree with me. That's one down at Wilmer Cutler and several to go I guess.

I want to talk a little bit about the general exclusion standards, but just for a moment, and then go on and talk about the application of refusals to deal.

As you know, there are two standards that people have been talking about, what I call the consumer welfare effects standard, I just want to focus on the fact that that's really the effective price and quantity effect, not some complicated balancing, and then the profit and no economic sense test. I favor the consumer welfare effect test. You know, it's focused on the goal of antitrust, it's flexible, it is an enquiry meet for the case, I agree with Bill on that. It implies a

tailored structural enquiry for each type of exclusionary conduct.

It's not an open-ended balancing of the sort that was suggested in Chicago Board of Trade, but rather there's a series of steps that one must go through and those series of steps differ for different types of exclusionary conduct.

For example, I spoke at the -- at this panel the FTC had last month on timber overbuying and so on, and I distinguished between predatory overbuying and raising rivals costs overbuying and depending on the characterization of the conduct, there was a different test that was used.

Should be still a different test for predatory pricing, still a different test for refusals to deal, still a different set of tests for exclusive dealing, but all within the umbrella of a focus on consumer welfare and this consumer welfare approach.

So, I don't think that the consumer welfare standard leads to balancing. I also don't think it leads to false positives. Indeed the sacrifice test is usually criticized for causing false negatives, but as I discuss in my article, it also causes false positives, and indeed I'll argue that with refusals to deal, the sacrifice standard would be more likely to cause false

positives than would the consumer welfare test.

We've talked a little bit about whether the innovation incentives are a reason to cut back Section 2. I'm going to talk about this before we get to refusals to deal, but just basically, you know, firms have incentives to compete, incentives to innovate in competitive markets. I believe it's the consensus of economists that innovation incentives are greater in competitive markets than in monopoly markets, monopolists have weaker innovation incentives than competitors. I would cite you to Mike Scherer's article, which is cited in my antitrust law journal article. And of course, you know, if a monopolist, if the dominant firm knocks the entrants out of business, then it will, of course, reduce the innovation incentives of the entrants as well.

Well, now, how would you apply this to refusals to deal? Well, here, you've got the consumer welfare test, we've got the first -- the profit sacrifice, or NES test, and then of course per se legality. What I want to say about this is that the consumer welfare test and the sacrifice test actually have a lot of similarities. They both require a price benchmark, and a lot of people say the price benchmark is the fatal flaw in anything other than per se legality. I'm going

to explain why I don't think that's true. And I'll also talk about why I think the sacrifice test is more likely to lead to false positives, because it does not have any or may not have any anticompetitive effects prong. And of course I say legality leads to false negatives.

Okay, so what should the rule be under the consumer welfare test? I'm going to talk about the rule. I have a hand-out, which you can pick up at the break, which sets out the rule I've composed in detail, but we can talk a little bit about that now.

There will be basically three pieces to it. First of all you have to show that the defendant has monopoly power, and that would be monopoly power in the input market and actual or likely monopoly power in the output market, so we're talking about a vertically integrated monopolist.

You would have to show that the plaintiff has made a genuine offer to buy at or above some benchmark price, and I'll talk in a bit about how you determine that benchmark price. So, this is not a matter of saying that the monopolist has to sell at cost, I'm going to come up with a benchmark that's going to compensate the monopolist adequately, and the plaintiff would have the burden of showing that it made an offer. So, the plaintiff can't go to the court first, the

plaintiff has to go to the monopolist and try to get the product, and if it fails, and the defendant, you know, refuses to deal, then there is at least potential for a case.

This test I use, which I call a compensation test, is going to compensate the monopolist for its lost profits for the customers that it loses to the entrant, and this is very much a sacrifice test, a no economic sense test. But under the consumer welfare analysis, you also require the plaintiff to prove anticompetitive harm. And that would be during the output market, or the input market, or some other -- some other market where the firms are actual or potential competitors.

It's not clear to me that the sacrifice standard requires this third step, and that's why I think it's going to lead to false positives. I think it only requires the first two. Now, if you actually parse the literature, Greg Werden probably does not have this third step. He has some type of incipiency standard for the third step. I think Doug Melamed, I think, adds this third prong.

In which market do I have to show anticompetitive effects? Well, that's going to depend on the case. But, you know, a refusal to deal could cover up, you know, a naked noncompete. For example,

you know, a contemporary example might be suppose Halliburton, which has a monopoly over certain transportation services in Iraq, suppose it says to a firm, I will only provide you transportation services in Iraq which you need in order to sell other commodities to the armed forces, I will only provide that input to you if you promise not to compete with me in providing oil field services in Louisiana.

Well, that's a refusal to deal, the harm would not be in the geographic market in whatever Halliburton competes in in Iraq, but rather some other unrelated market. So, it's possible that this litigation could be brought here.

Or, you know, more generally, if it's not the input or output market, it's going to be a complementary product, it's going to be a complementary product market.

So, notice, this consumer welfare test, it's not an open-ended Chicago Board of Trade inquiry, have to show market power, have to show anticompetitive effects in a particularized way, and you have to show that the price offered by the plaintiff meets the compensation test.

Okay. Well, the real issue is, what about this price benchmark? This is where the controversy is. And

there are several candidates, as Hew pointed out. There's the prior price paid by the plaintiff, as in the case of Aspen. It could be the price charged to other buyers, which also was an issue in Aspen, where they were willing to deal with other mountains in other ski resorts. Or there could be some benchmark, if the first two don't work, either because there's no course of -- previous course of dealing, or because of some reason they're not appropriate, and I agree with you that they may not be appropriate, then you need another benchmark and the benchmark that I've come up with is a benchmark I call protected profits benchmark, and it's a price that compensates the defendant for the monopoly profits lost to plaintiff from losing -- from customers that shift from the defendant to the plaintiff.

I'll give you an example. So, it is a sacrifice test, it is giving the defendant the monopoly profits that it's earned, and I think that's a key issue. You might want to adjust this benchmark. For example, suppose dealing with the plaintiff raises the defendant's production costs. Well then you would have to take that into account in setting the benchmark. Suppose the plaintiff creates real reputational free-riding, you know, suppose it says, well, we've used -- we've used this input that we got from GE, and

suppose their product is no good, and that hurts GE's reputation, well that could would be a reason why GE should be permitted not to deal with them or charge them a higher price.

And lastly, suppose the monopoly, we've been acting up until now that these monopolies are attained legitimately. If they're not obtained legitimately, then it's not clear that you want to give someone protection from the monopolist. Not clear that you would worry so much about protecting those monopoly profits or protecting the incentives.

Finally, the other adjustment I would make is this is a rule intended to generate negotiation, so if the defendant just has a flat refusal to deal, a non-negotiable refusal to deal, or only makes sham offers, as they did in Aspen, then the burden is going to shift to the defendant to show that the plaintiff's price offer was good.

So, for example, in Aspen, it's not as if Highlands said, I'll pay you ten cents for the daily tickets, and Ski Co. said, no, no, no, I want $44, that's much more reasonable, and Highlands said, I'm going to sue you. It wasn't like that at all. In fact, Highlands made an offer, in fact the retail price, but Ski Co. made a counteroffer designed for Highlands to

turn down. I mean, it was not a real counteroffer, it was one that Highlands would be forced to reject. So, I place some burden on the defendant in those circumstances.

Okay, so how do you calculate this? Well, this is the part with the math, but as I tell my law students, this is not really math, it's just shorthand, it's just abbreviations. So, my benchmark has two important properties to it. One is it compensates the defendant for the monopoly profits that it loses on the customers that it loses to the plaintiff. However, it does not get compensation for price competition that's induced by entry by a firm that has lower costs or superior product.

So, I'm compensating them for their monopoly profits they have, but I'm not allowing them to deter entry by a more efficient competitor, one that has lower costs or a better product. Where did I get the standard from? Well, I didn't invent it. This goes way back. It's called the efficient components pricing standard, first started in the late 70s or early 80s. It's been referred to in the context and there's been a lot of commentary on this basic standard by people, among others, John Vickers, who just left heading up the OFT in Europe.

The way you calculate this, this benchmark price, is the monopolist's input cost, plus it gets its margin, plus its margin times the fraction of the plaintiff's customers that get diverted from the monopolist. This is not -- it's not a lot of letters, it looks like algebra, but it's not really so complicated.

So, let me give you an example to show that, and I'll use -- suppose the Trinko case were not in the context of regulation, how would you, you know, how would you use this protected profit standard? Well, here's the data. Suppose Verizon's incremental cost of providing DSL, wholesale DSL, suppose that were $10. Suppose Verizon's margin on retail DSL, their monopoly margin, suppose that were $50. And suppose that if Verizon sells wholesale DSL to AT&T, half the customers AT&T gets will come out of the hide of Verizon, and the other half will come from cable and dial-up. And yes, I know Verizon provides dial-up in its own territory, but they probably don't make much money there, so I am just leaving that out for now. But if you will, you could make it more complicated to take into account the dial-up margin, but I think Verizon probably sells at a negative margin on dial-up anyway.

So, under these circumstances, half of AT&T's

retail DSL customers are going to come out of Verizon, half are going to come out of the hide of Comcast, Time Warner and so on. So, this diversion rate would be 50 percent. Diversion rate, you know, it's something we use in mergers all the time.

What would be the benchmark price? It would be $35. Verizon's $10 cost, plus they get a monopoly margin of $50, they lose that monopoly margin on half their customers, so half of $50 is $25, you have to compensate them for those expected losses, that gives us $35. Okay?

If AT&T were going to get all its customers out of the hide of Verizon, then the benchmark would be a lot higher, it would be $60, Verizon would have to be compensated for its costs, plus the margin that it lost. Okay? Not so difficult to do this at all.

Under this standard, and this is another sort of key aspect, I probably should have put it on the previous slide. The entrant will not be able to succeed in the market under this standard, unless it has lower costs or a superior product for at least some consumers. So, this is not a prescription for inducing inefficient entry, the only kind of entry that gets induced as a result of this test is efficient entry, and therefore I think it meets the -- I think it meets the standard.

So, for that reason, I think this, you know, this consumer welfare standard, look at how much the plaintiff has to prove. Monopoly power in the input market, you know, if the entrant's got an alternative, then they're out. The defendant has to have actual or potential monopoly power in the output market, or else the plaintiff loses.

A lot of things for plaintiffs to prove. It's got to prove that the price offered exceeds the test, a test that I don't think is very difficult for a firm, certainly not a firm like Verizon, to calculate. I don't think it's hard for any firm.

This is the same sort of data we routinely use for merger analysis, and that a firm needs to run its own business. A firm needs to know its margin. And in fact, it can look up its margin, it can ask the CFO for their margin, it's on the profit and loss statement and should be on the profit and loss statement for each division. And they just need to know the extent to which they compete with the plaintiff.

And the plaintiff here also has to prove anticompetitive effects. So, there's big barriers for the plaintiff here. So, this is not -- this is not a standard that's going to lead to overwhelming amount of litigation.

Now, this is the standard, how do we deal, what do we have to say about Trinko? Well, Trinko raises a number of cautions that have been discussed by the earlier speakers. They pointed out that there's no general Sherman Act duty to deal, and they said forced share, I guess red flags is my term, the justice division did not use the term red flags, but it raises a number of red flags. Lessens investment incentives, requires courts to act as central planners, that's the red flag. And the compelling negotiation can facilitate collusion. All of this adds up to the concern with false positives.

Well, let me go through these and look at these in a little more detail. Well, first of all, the no general Sherman Act duty to deal, that's true. I teach antitrust, every antitrust professor knows that. I wish that in the Trinko opinion, however, they had quoted Colgate correctly. They said Colgate stands for no duty to deal. The proper quote says, i.e., in the absence of any purpose to create a monopoly, there's no duty to deal. So, Colgate is limited and in that Justice Scalia tried to change the meaning of Colgate.

So, what about these more detailed questions? Well, first is this investment incentives, this has been alluded to by several speakers. I think the first

point, the key point is the benchmark price compensates the defendant for the monopoly profits that it loses on customers that it loses to the plaintiff. So, in terms of reducing their investment incentives, we're making, and I thought Hew was exactly right, it is a liability standard. It's making them whole on the profits they lose, on the customers that they would lose to the plaintiff.

But there's other reasons why I think it will not reduce investment incentive. First of all, Scalia worries about reducing the entrant's investment standards, that the entrant would otherwise enter the input market on its own. But that is a very weak statement. I mean, you don't get into one of these cases unless the defendant's got monopoly power in the input market, and what we mean by monopoly power is durable monopoly power. What we mean by durable monopoly power is that there are high barriers to entry.

So, unlikely that the plaintiff otherwise would have entered the input market. It also means you can't get into the -- you can't enter one market at a time, you're unlikely to see leapfrog competition. Secondly, we know the competitive markets increase the defendant's innovation incentives. Monopolists have weaker innovation incentives than do competitors and, you know,

I mean, the telephone companies have a million excuses for why they never innovate, and we have just heard some others.

I think that -- but I think if they had faced more competition, they would have stronger innovation. They are certainly innovated in trying to come in to compete with cable, where they don't have -- where Telecom is not -- where telephone companies do not have a monopoly.

Of course entering the output market will increase the entrant's innovation incentives. And finally, and this is I think a key point, and I think in Bill Kolasky's list of cases, Kodak was conveniently left out. In Trinko, Kodak doesn't get mentioned. Well, one very important point that was made in the Kodak opinion is that you can't call the entrant a free-rider if they only enter one market rather than all of them.

Kodak says that this understanding of free-riding is an argument made by -- made by Kodak, and the Supreme Court said, this understanding of free-riding has no support in the case law. So, you know, I think that argument just does not add up.

The courts as central planners, I'm running out of time, so let me go quickly. You know, I guess the

point I've been making all along is this isn't so hard. Market prices often provide a good benchmark. I think this protected profits compensation benchmark is not too difficult to evaluate, and then the other point I want to make here is, you know, if antitrust withdraws, it's not clear that we're going to have laissez faire. This has not been the way the United States economy has worked.

When antitrust fails, we often get real formal public utility commission regulation, real central benefits, and so I just want to raise the question about whether we're really going to get ourselves into the federal operating system commission if antitrust drops out. And of course the essential facility doctrine fits in here.

Okay, finally is this issue about facilitating collusion. I think that one is really silly. You know, if you believed -- if you believed this argument that letting people negotiate is going to facilitate collusion, well then we also prohibit voluntary dealing, we also prohibit joint ventures, we also prohibit patent settlements, which we know from the FTC experience are sometimes used to strike noncompetition agreements.

It's also, you know, the refusal to deal can be used, if it's a threatened refusal to deal, can be used

to facilitate collusion. I'll sell to you, but only if you promise not to compete with me. So, I think that the -- that effect put out that dicta by the Trinko court was really they -- it's either insignificant or goes the other way.

Finally, I want to raise the question of if we go down Hew's route for per se legality, where are we going to stop? I note that's perhaps not a question that Hew is worried about, but it's a question that I'm worried about. If it's per se illegal -- per se legal to refuse to deal with firms that compete with you, then what about exclusive dealing? Why isn't that, per se, legal, either with respect to whether if the firm wants to buy stuff from you, sell it to your competitors, or if they want to buy from your competitors? What about the tie-in? Why doesn't it make tie-in per se legal, because that's just basically refusal to deal. What about noncompetition agreements? What if a firm says, like in my little Halliburton example, we're going to compete with you in some unrelated market, and they say, well, in that case, I'm not going to sell to you. Well, that would be -- that would be per se legal.

And finally, what if they use a refusal to deal in order to force the firm to raise prices, either in the market -- the output market that we're talking about

or some other market. Would that also be per se legal for them to make that argument? So, I would be quite concerned about that.

I'm out of time, thank you very much.

(Applause.)

MR. ABBOTT: Thank you, Steve, for presenting an attempt to establish an administrative rule that will undoubtedly bring forth some more discussion about the rule that might apply in evaluations under the rule of reason.

Now we have another economist who is going to take a crack at this difficult set of topics. Tom Walton, director of economic policy analysis, General Motors Corporation, in which position he oversees the analysis of costs, current and prospective governmental policies and regulations, and their implications for General Motors. Tom Walton received a Ph.D. in economics from UCLA, was assistant professor at NYU, before joining GM, and served briefly as special advisor for regulatory affairs at the FTC. He's vice chair of the Business Research Advisory Counsel for the U.S. Bureau of Labor Statistics in Washington, D.C.

Tom?

(Applause.)

MR. WALTON: Thank you very much. I'm going to

try a little bit of a change of pace to give you an idea of what it's like to be inside the fish bowl of competition.

Well, it all began back in 1963 when the Federal Trade Commission launched its first investigation into the manufacturing and distribution practices of the major auto makers with regard to the production and sale of their single source crash parts. Now, these are the parts that are most frequently damaged in the event of auto accidents, and which also happen to be single source. They include radiators, bumpers, fenders, grills, all the sheet metal. They don't include glass, because glass is multiple source.

At that time, Chrysler, Ford and GM, the major manufacturers at that time, distributed these parts exclusively through our franchised auto dealers. Our franchised line-make auto dealers. That's an important distinction. For example, Chevrolet parts we distributed exclusively through Chevrolet. If an independent body shop wanted to buy a part, it could only get a Chevrolet brand part at Chevrolet, they could not get it at Pontiac, for example.

Insurance companies instigated the investigations. Congressional investigators had been constantly pressing them to reduce their auto insurance

premiums. Insurance had a pretty good handle on the labor rate at the auto shops, both at the auto dealers and the independents, but they wanted to set up independent warehouse distributors or wholesale distributors so they could get similar concessions on parts. They brought along with them the lobbying arm of the independent body shops, or IBSs, as they called themselves. They complained that GM and other auto manufacturers, everyone used the same system at the time, were discriminating against them because they -- because in the case of the independent body shop, they had to buy the part from the dealer at a mark-up, or have the dealer provide the part directly from the manufacturer, General Motors or another manufacturer at wholesale.

Of course, the auto dealers, like any other retailer, have the wholesaling cost. They have the cost of ordering, carrying, insuring and financing the distribution of the parts. And of course they charge for those wholesaling services. So, the IBSs, the independent body shops and insurers went to the Congress and went to the Federal Trade Commission to try to force us to directly sell those parts, those single-sourced crash parts to the body shops and to the independent wholesalers.

Little interest was expressed by the large warehouse distributors, and later they would testify that they had no interest in taking on the business. They also believed that there was no need to take on additional wholesalers, additional customers. There was no shortage of GM dealers to handle the business. There's something like 12,000 dealers spread out in every area of the country. They thought they could do the best job of handling the bulky and complex repair parts because in part, they shared our incentive to keep the customer happy and make sure that the owner of a Chevrolet vehicle was put quickly and efficiently back on the road.

Sure, they shared our interest in the integrity of the brand name. We believe that opening up the system to tens of thousands of independent body shops would reduce the availability of the parts and increase the time necessary to get them to the customer. We knew it would impose substantial additional administrative and monitoring costs. We didn't feel we could derive the monopoly profits from pricing the parts, because we would be jeopardizing 95 percent of our business, that's the vehicle business, by trying to achieve a monopoly on the parts.

Higher priced parts would have meant driving up

the repair costs for our customers, and would have reduced the likelihood that a Chevrolet vehicle owner would become a repeat customer. We knew that one company, Renault, had recently ceased doing business in this country because of a faulty service repair system. Another company, another competitor, Chrysler, had spent something like $350 million to convert from the system the FTC was proposing, this open warehousing, open distribution system, back to the system of distributing the parts exclusively through its franchised dealers.

We did offer subsidies for GM dealers to sell the parts to the independent body shops at reduced prices. In order to pacify them and to pacify the Federal Trade Commission, in September 1967, we proposed a plan in which we would offer a 12 percent discount on the parts resold through the independents. A program we then called wholesale compensation.

In February of 1968, the Commission, though, told us that they intended to file a lawsuit in order to bring about price parody between the GM dealer body shops and the independent repair shops. Further negotiations ensued and in the fall of 1968, the Commission accepted our proposal to raise that subsidy, that incentive for reselling to 23 percent. Accordingly we increased our prices on all crash parts in order to

try to recoup the cost of the program, including those costs of administration and monitoring.

Later, the Commission would estimate the total costs at $70 million per year, that's almost half of a billion dollars per year in today's dollars. Now, we knew the promo would be expensive, but we thought that opening up our warehouses would be still more expensive. Well, the arrangement did not satisfy our critics for long.

In the early 1970s, in the era of wage and price controls, the President's Council on Wage and Price Stability raised its own pricing investigation into crash part pricing. The investigation provided an extended period of full employment for an economist like myself at the auto companies and in the President's Office of Management and Budget. It turned out that much of the increase in prices was by the newly installed auto pricing regulations, especially by the bumper standards that were being -- that had been suggested by the insurance companies, and that in that case, not being to enhance safety, but substantially increase the price of our bumpers, which accounted for 40 percent of any kind of a crash parts price index.

As you can see, the relations between us and the insurance companies wasn't the best at that time. In

1970, the Commission launched yet another investigation. What did the Commission want this time? Nothing less than a remedy at the manufacturing level. That we be required to make a unique and extremely expensive tooling for these crash parts available to outside manufacturers.

Fortunately, they later dropped this proposal. We heard that their Office of Policy and Planning Evaluation had estimated that if successfully implemented, the proposal would increase crashed parts prices by somewhere between 150 and 580 percent. But the Commission still wanted GM to sell its GM-branded crash parts "to all vehicle dealers, independent body shops, and independent wholesalers at the same prices, terms and conditions of sale, said prices to be subject to reasonable cost-justified quantity discounts and stocking allowances." And I would disagree with my friend, Steve Salop, on the simplicity of arriving at that kind of price.

We made one final effort to stave off litigation. In early October 1975, we raised our wholesaling discount to 30 percent of the dealer price on the crash part resale to independents. In early 1976 we announced that we would broaden the plan to allow all GM dealers to distribute all GM crash parts to anyone.

This meant that independent body shops could now buy that Chevrolet crash part from a Pontiac dealer or from any other General Motors dealer. The program never took hold. The independents stayed with their existing dealer suppliers. Chevrolet for Chevrolet parts, Pontiac for Pontiac, so forth. This confirmed our belief, at least to us, that the existing system was an efficient way of getting our parts to the independents. None of it worked.

By March 22nd, 1976, the Commission issued a complaint charging GM with unfair methods of competition for refusing to deal with everyone on the same terms we gave anyone. It said that the wholesaling parts discount had not achieved price parody between us and the independents -- between our dealers and the independents, and that "the consumer was being asked to subsidize the wholesaling profits of the dealer," which it was, "and that eliminating the program resulted in an estimated drop of 10 percent in consumer prices."

So, some 13 years after the initial investigation had begun, we were in litigation over our right to choose the customers with whom we would deal. The Commission extended freight upon us for what they called a "duty to deal." As an economist, I was the economist assigned the case. Did we consider settling?

Yes. But Frank Dunne, our lead General Motors counsel in the case, and his superior, Tom Leary, the recently retired FTC commissioner, and Bob's former colleague, pressed management to stay the course because in their words, "It was the right thing to do."

They also felt that GM would ultimately prevail in the courts, if not with the full Commission. They did not want to surrender GM's right to freely and voluntarily choose the customers with whom we would and would not deal. We did not want to be forced to accept a system that was less efficient and less competitive. Somehow the complaints and investigations never resulted in any Commission actions against our competitors. Our chairman, Tom Murphy, agreed, and the rest is history. We fought the charges to the bitter end.

Three years later, on September 24th, 1979, the ALJ, Administrative Law Judge, found no evidence that GM's refusal to deal and its pricing policies injured the independent body shops as a class. Every independent body shop witness was doing very well, and the industry was doing better than comparable industries, growing faster than, for example, our own General Motors body shops and general repair shops.

He also found no harm to independent part distributors. Crash parts prices were actually rising

less rapidly than general inflation and, normally less rapidly than the price of the so-called competitive products, such as spark plugs and fan belts. He found that "creating a duty to deal would increase GM's distribution costs." He said, and again I quote, "The evidence here does not show that GM has discouraged, defeated or prevented the rise of new competition in the new GM crash parts market."

He concluded that GM did not have any predatory intent in establishing the system and that there appeared to be "no substantially adverse effect on competition attributable to the refusal to sell new GM crash parts to anyone other than GM dealers." He did find, however, that under Section 5 of the Federal Trade Commission Act, that we had unfairly discriminated against the independent body shops whom he found had to pay more for the parts than did our GM dealers. He agreed that, indeed, some of our dealers were engaged in extensive wholesaling and thus engaged and incurred extensive wholesaling costs, but he rejected our contention, based on our own GM financial studies, that when the dealer's wholesaling and carrying costs were included in the prices that their body shops had to pay, were actually below the prices that they were charging the independent body shops.

He ordered us to terminate our wholesale compensation plan. He decreed the implementation of the joint GM/Commission staff which would "cooperatively" devise a nondiscriminatory plan for distributing new GM crash parts.

The Commission staff appealed, the headline in the October 4th Washington Post read, "FTC Challenged Its Own Ruling on GM Crash Parts." So did we. Finally, on June 25th, 1982, the full Commission dismissed the complaint in its entirety. Unlike the ALJ, they did find injury to competition to the independent body shops -- to the independent body shop repair witnesses, I should say. But in their words, apparently, and in spite of the fact that they could find no overall injury to the body shops as a class, what disturbed them was this perceived difference in price at the GM repair shops and body shops, independent body shops.

The Commission found, though, that the injured body shop competition was offset by business justifications. That creating a duty to deal could result in higher costs of distribution, which ultimately would be passed on to consumers in the form of higher prices for GM crash parts. Just as we had said 19 years earlier.

They found no injury to competition in wholesale

parts distribution. Most importantly, they rejected the proposed remedy as unworkable. They did not want the Commission to be involved in "ongoing supervision of the system." They did not want to, in effect, become another Council on Wage and Price Stability, having to, "commit extensive resources to reviewing GM's interpretations of to whom and at what price it could sell these crash parts."

The long ordeal was over. After 19 years of investigation and tens of millions of dollars in corporate and commission resources, we have not opened up our distribution system since. We have not sold crash parts directly to independent body shops or to independent warehouse distributors. Neither has anyone else. We did drop the costly and ineffective wholesale compensation plan, the subsidy for dealer resales.

We have further simplified our pricing program, in response to the modern computer and the high speed Internet. In the final analysis, the issue came down to who can more efficiently manage GM's business? Who can more efficiently choose the customers with whom we deal and the prices we charge? We share the Commission's interest in an efficient system of distribution and in keeping the car buyer happy.

So, the only question, was and is, who can do

the better job? Thankfully, on June 25th, 1982, the Commission finally said, and for very good reasons, it did not want to second guess our business judgment anymore. We could only hope in the future that the courts and the Congress also will share these sentiments. Thank you.

(Applause.)

MR. ABBOTT: Thanks, Tom, for a cautionary tale about agency antitrust enforcement. One of the things we are hoping to do in these hearings is to get the views of business planners, people inside the businesses, and their reactions to antitrust enforcement.

Our next speaker also comes from the business world, Mark Whitener, senior counsel, competition law and policy at General Electric Company. Prior to joining GE, Mark was deputy director of the Federal Trade Commission's Bureau of Competition, where he was responsible for a variety of antitrust enforcement and policy initiatives, where he worked on merger guidelines, health care, intellectual property, and international enforcement. Mark also spent several years in private practice in Washington and London prior to joining the FTC. Mark has written widely, testified before Congress, and was editor of the ABA

antitrust section's antitrust magazine.

Mark?

(Applause.)

MR. WHITENER: Well, thank you. Tom did all the heavy lifting for us now, and makes my job a bit easier, because I can just tell you what I think are all the policy implications of what Tom just said. I'm going to urge the agencies to use these hearings to set out a pretty simple position on this topic, and the topic that I'm addressing is unilateral, unconditional refusals to deal with competitors. I think other forms of behavior that take the form, for example, of the vertical restraints or exclusive dealing, I think all of those are readily distinguished from what we're talking about here today. Perhaps we can get into that during the discussion.

So, it seems to me that what the agencies can do here is set out a position that you can call it per se legality, I suppose, but my sense is that we're really not creating a rule of exclusion, but what we're doing is addressing rules of definitions. What does it mean when we talk about exclusionary conduct under Section 2? And I think that what the agency should say is that unconditional refusals to deal with competitors simply do not constitute exclusionary conduct. And I think

that position, by the way, can be taken consistently with any of the various analytical models one might choose for looking at Section 2 issues generally.

That position can be consistent with an aggressive view of how to look at other forms of behavior, or a permissive view, because definitionally, it seems to me what we're saying is that when we try and define what is exclusion, versus what is the simple exercise of one's property rights, or even one's market power, if that's what we're -- if that's what exists in the technology, that we're taking the rights to one's property, that exploiting those rights unilaterally, that choosing not to deal with competitors by supplying them licensing is within the inherent property right, or if market power exists, is simply the exercising the market power and not the unlawful maintenance of increasing that power.

If the Commission were to take this position, it seems to me that there are a couple of positive effects. Not including, by the way, any significant shift in federal enforcement policy. This is not an area where the agencies have been active for many years, and I think quite rightly so.

When businesses look at this issue and assess risk, they're looking at two things. Private

litigation, which plays out before generalist judges and agencies, and increasingly international enforcement. And I think for the agencies to take a clear view, clear position on this issue, would not only promote the sensible interpretation of the law in the U.S. as it's applied to private litigation, but also can help us advocate for sensible policy abroad. And I'll come back to that topic in a moment, but I think it's a very important one.

The ramifications of this approach would be essentially to say that unconditional refusals to deal with competitors are not exclusionary, regardless of the nature of the property, intellectual or otherwise, regardless of whether the property owner began dealing and stopped or never began dealing at all, I believe we made that point. It's not a meaningful distinction or way to distinguish between anticompetitive and competitive action, regardless of the property owner's reasons for not dealing. Whether we use that as a question of intent or pretext or otherwise. And regardless of the price that's charged, if a firm with monopoly power decides to deal, and decides to exercise the right that's recognized elsewhere in Section 2 to charge different prices for different end users and in essence price discriminate, this conduct, standing

alone, is not a Section 2 violation.

Because again, as an analytical matter, I'm not advocating changing the law or defining a category of practices that otherwise are exclusionary as lawful, but simply recognizing that what we're talking about here in this clear case of the unconditional refusal whether to license or to sell, this is simply the exercise of all the rights and the capturing of all the value inherent in the firm.

Now, the reason for this, analytically, what exists with antitrust and the reasons for this have essentially gone off the radar. The reason why these cases are rare is because in most instances, courts either through express analysis or intuition come to a view essentially like the one that I'm describing, but if you ask judges and juries to apply the ill-defined standards that exist today, some of them are going to answer the question the other way. You're really not given much guidance in terms of how to address it.

There is, I think, an important incentives issue in play here. I think Bob asked the right question, which is where's the evidence? I think we should be looking for evidence to underlie more of our antitrust judgments, in many areas of the law, rather than relying on intuition or case law or anything else that might not

really tell us a lot about reality.

So, I think it's a fair question. Hew offered some examples, some studies. I do think, though, there is a doctrinal or analytical or philosophical question here to be answered in terms of incentives, and that is we, I think, should assume, you're entitled to assume that incentives are diminished when firms are forced to share their property and their technology. For the same reason that we assume that the antitrust laws bring something positive to the economy.

The antitrust laws reflect a belief in a competitive model, and it seems to me that forced sharing, which I think is a fair way to describe as a corollary to the refusals to deal area, in essence replaces the competition with regulation. I don't think we can imagine any remedy to a refusal to deal case that is not in some very substantial sense regulatory. And you can talk about the various models and Steve has made a serious attempt to describe how one may engage in that regulation, but I think we have to call it what it is, which is price regulation of every firm that is being forced to share.

Now, Trinko was a step in the right direction, in general terms, in the sense that it expressed a skepticism about refusals to deal and a skepticism about

its cousin essential facilities. But what Trinko didn't do, by following this Court's tendency to decide cases generically with a sweeping view of the actual holding, is the scenario of what exists after Trinko and what has been applied by the lower courts following Trinko. There are several analytical tests that really are not satisfying, that really don't help businesses evaluate risk very well, and that really don't pose a meaningful way to distinguish between precompetitive and anticompetitive conduct.

Most of these have been referred to already. This question of whether one has ever dealt or has stopped dealing with a competitor. Well, that may be, as a factual matter, something that reduces litigation. Whether a firm is more likely to have a happy competitor, if you deal with them and stop, that doesn't really help us say what is or isn't anticompetitive.

The question of whether someone's refusal relates to intellectual property or not. Not a question that Trinko exactly addressed, but certainly an issue that now is clear that there is a -- there is arguably a different treatment under the law, depending on whether you look at Xerox or the decision in Kodak or Trinko. Depending on whether the property is intellectual or tangible, depending on what circuit you can be sued in.

The question of intent, and this I think is a really important point in understanding why I think we should not view unconditional refusals as exclusionary at all. The intent by a firm that has developed a product or technology is always essentially the same. Regardless of how they express it in the conversation or in the documentation, that intent is to maximize profits, to maximize the returns on the investment in that product.

That intent might be expressed in ways that are very pleasing to the ear of the antitrust lawyer or a judge or a jury, protecting the intellectual property rights. Kodak tells us that that's legitimate and contextual. Maximizing returns on investment. As opposed to other sorts of ways to describe profit maximization, which might in the case of refusal to deal, essentially say, keep -- make sure I can keep this all to myself. Make sure I can exclude other types of service competitors from competing with me. Well, that begins to sound like something in the words of the model jury instruction that the ABA has put out on refusals to deal. Like something that is intended to block competitors.

If you look at the jury instruction that the ABA has promulgated in this area, blocking competitors is

not a legitimate business justification for the refusal to deal. Now, how do you distinguish blocking competitors from the actual fact of keeping the returns for myself, maximizing my profits, maximizing the return on my investment.

So, I think the fact that Trinko has perpetuated the law in language that I found so surprising when I read it coming from Justice Scalia's process and his clerks. This procompetitive zeal, anticompetitive malice, language is not helpful. And some of us may think, you know, as we see it, the risk here is not that our colleagues in the federal agencies are putting forth cases, it's that claims will be filed, it's that judges will look at the law and conclude that they have to let it go to trial, it's that juries will be asked to decide, in essence, when you boil it down, whether this refusal was good or bad.

And again, I don't think this is an area where we're facing the onslaught of litigation. It is an area where I think there is some natural tendencies that diminish the number of cases that are filed. Section two cases are not quick hits for class action lawyers. They're not -- if you get to trial, they're massive and resource intensive. They may have settlement value, so there is risk. They certainly impose costs on firms

that have to defend them if they're brought and they have to counsel around them if they're not.

So, I don't think Trinko really settled it. I think it was a step, some might say, and Bob might be right, it was a signal of a very fundamental or philosophical view. The lower courts aren't bound by a philosophical view, they're still allowing some cases to go through.

And I think the jury instructions are instructive. If you look at monopolization instruction two and three, if you put those together and you ask yourself, for example, if I'm a firm and I've developed a piece of sophisticated equipment, maybe it's got some patent protection, maybe other parts of it don't, it has parts, integrated parts, I provide service, and for now I'm the only service provider and for now I've decided not to sell parts, or make it a little bit easier, I've decided not to train my competitors. Service organizations come to me and want to pay me Steve's monopoly price or exclusionary price, they want to pay me a lot for service, or service training, train them to come in and service my equipment. And I decide I'm not going to set up a service operation, I'm not going to offer that service to my competitors. And so in the short run, I would make a lot of money this quarter if I

sold my service, but I know over the next two or three or four years, my service is going to be substantially lower, because I've created competitors in my service operation.

So, then I think we have the profit sacrifice. I think if I understand the test, and again, the question here is not to criticize the profit sacrifice test, it's to say that we really should not put that behavior in that test at all, because I don't think it should be viewed as exclusionary.

So, just to finish up, private litigation is where the real risk is in many of these areas. It's not a question of the floodgates being opened. I think the floodgates were probably turned down a bit after Trinko, but I think the agencies can be more instructive, and I think in the international market, this can be much more than theoretical. U.S. enforcers and practitioners and academics go out and talk to those in other countries who are developing laws or who are developing enforcement policy, such as the European Union review of Article 82, or who are creating an entirely new anti-monopoly law, as is happening in China, we see subtle expression of this policy, or in some cases very unsubtle expressions, such as an essential facilities doctrine written in ways that were similar to the U.S.

version, or even a doctrine written similarly to some of the recent cases in the refusal to deal area. We look at that and we're concerned, because we understand how it can be used, and in fact, it's likely to effect on limiting innovation and being used to confiscate property, being used to bring about industrial policy, being used to bring about a different economic status that some regulator may prefer than the one that would happen if people who innovated brought in terms of innovation.

And when we are commenting on those issues, and I've experienced this myself, sometimes the audience says yes, but you have the essential facilities doctrine, or you have refusals to deal. In fact, we've basically taken this out of cases, post-Trinko cases, and these are the questions that we're going to empower our regulators to ask, and by the way, very substantial fines or other penalties that can come into play for the violations. I think the way that would be described in other countries, I think that is diminished when we still have work to do in cleaning up the vestiges of these sorts of policies in our own law. I think this could be applied to refusals to deal.

(Applause.)

MR. ABBOTT: Thanks, Mark, for bringing in the

international dimension and the vagaries of juries and jury instructions. Quite interesting. We are going to take a ten-minute break now, and I would urge people to try and get back here as promptly as possible. Thank you.

(Whereupon, there was a recess in the proceedings.)

MR. McDONALD: Ladies and gentlemen, thank you for your attention and returning to your seats following our very outstanding presentations from the panel. As promised, we will ask the panelists to take about three minutes each to respond to panelists' remarks, to defend their remarks and to defend their honor. We will go in the initial order that they made their presentations.

Bill Kolasky?

MR. KOLASKY: Thank you. Thank you very much, Bruce. I realized when I sat down that I hadn't really gotten to the punchline of my presentation, which was how do you apply the Section 2 depth-wise sliding scale rule of reason to refusals to deal. And so I just wanted to sort of move through that very quickly. First, I agree with those who say, and Mark Whitener in particular, that in general unconditional, unilateral refusals to deal ought not to be unlawful. And so I think in evaluating competitive effects in the first

step of the rule of reason analysis, courts should distinguish sharply between a simple unilateral refusal to deal, and a refusal that is part of a broader pattern of anticompetitive conduct.

The classic example of that is the MCI/AT&T case, where AT&T basically played rope a dope with MCI in their negotiations over interconnection and their misuse of the regulatory process through sham litigation. That was what really constituted the exclusionary conduct.

Second, in evaluating proper justifications, courts should, and here I agree completely with Hew, as Phil Areeda used to say, courts should really take into account macro justifications, namely that they should recognize that a monopolist's desire to capture the value of its investments and innovation is part of what stimulates the economy. It is competition on the merits, and it is a legitimate business justification in and of itself.

Third, as with any rule of reason test, with respect to refusals to deal, the degree of scrutiny of the proffered business justifications, including that one, should depend on the strength of the showing of anticompetitive effect. But most importantly, courts should not substitute their judgment for that of the

monopolist, as to its business strategies, as to what is the most profitable business strategy. And then finally, again agreeing with Hew, courts should not impose any remedy that they cannot efficiently enforce.

I know we're going to talk about the efficient -- the essential facilities doctrine, so I am going to save my remarks on that until we get to it. Thanks.

MR. McDONALD: Thank you. Bob Pitofsky?

MR. PITOFSKY: Bill, let me start off with a question, in your sliding scale approach to refusals to deal, which I found very helpful, but what do you do with a situation, you get to step three, the defendant says, well, I had these good business reasons, and then you say, well, the burden is now on the plaintiff to show that they are not persuasive. And suppose the plaintiff somehow falls short? Is that -- that's the end of the deal?

MR. KOLASKY: No, I think that there could be a case in which the plaintiff is not able to rebut the justifications, but nevertheless shows that there are anticompetitive effects, and you might have to engage in a balancing then of the anticompetitive effects against the procompetitive benefits of the conduct. My point is simply, if you look at Section 1, rule of reason cases,

courts almost never reach that fourth step, and I doubt that they would reach it very often in Section 2 cases.

MR. PITOFSKY: I think that's fine, I couldn't -- I'm comfortable, entirely comfortable with where you are, and I think the emphasis on why they did it and what their reasons are is certainly where the emphasis should be, and if you get to step four, where you have to balance anticompetitive effects against something, you know, it's really a crap shoot, and very hard to expect the judges, much less juries to do that in a reasonable and rational way. And I don't end up agreeing with too many people up here.

Mark, I think your unconditional refusal to deal, conditional refusal to deal is an excellent way of introducing the subject. I'm just a little uncomfortable with absolute select safe harbor. I go along with you as far as strong, strong presumption, but then I sort of get off the train, because I worry about the really unusual case, and I think IHS in Europe, and I'm not one to know enough about it, but I'm going to oversimplify it. A company with a monopoly position on a form of intellectual property says I will deal with A, B, C and D, that's all fine, I'll work out the terms, but as far as X, you've already said that you want access because you want to be my rival, and I'm not

going to do that. And I refuse to deal with you. And then it turns out on careful analysis that the alleged investment, all the incentive, all the work that the monopolist is supposed to do, approached zero. This monopoly fell in its lap, and yet it refuses to license a rival. It is, it is a sort of an unconditional refusal to deal, but I would like someone to take a look at it. I would like to not close the door before a little more analysis takes place.

Third, I mentioned that I looked carefully at Greg Werden's piece on no economic sacrifice of profits. You know, when you get to the end, after all the talk about universal meetings, he has a balancing test in there, too. So, there's going to have to be some sort of balance, and I'll stop there.

MR. McDONALD: Thank you. Hew?

MR. PATE: Not surprisingly, I would like to close the door, and I think when Steve and I have talked about this, he says in a way, my part of this is much easier, because basically everything I'm saying boils down to don't try this at home. And that's right. And it may be fine for Professor Salop to put -- charge up and to propose formulas, but the basic thrust of my presentation is that if businesses are required to undergo this sort of exercise in district courts in

front of juries, that the uncertainty and the lack of predictability that is created are going to be harmful to economic activity. That does not make me, as Alden suggested, an antitrust skeptic, it makes me a skeptic about the ability of antitrust to provide general rules that should require firms to assist their rivals.

I'm not a skeptic about doing this in Section 1, in the same way, I think some of the examples that Steve mentioned in terms of the Halliburton example, reaching an agreement not to compete in Kansas in return for getting transportation in Iraq, or what have you, you know, that's a Section 1 agreement not to compete. It need not be characterized as a Section 2 refusal to assist, and I don't think that there's any slippery slope that leads from saying you shouldn't have that sort of duty to authorizing everything else.

As to the balancing test and the meet for the case and these sorts of things, the problem is that the information to make these decisions is not going to be available to businesses at the time they have to decide whether to undertake the unilateral conduct, and deciding what the consumer welfare effects are going to be is extremely difficult. It is not the same as what the agencies do or purport to do in a merger context, where both parties have voluntarily entered into a

transaction knowing that all of their information is going to be available, that third party information is going to be available, and that a prediction can be made. Very different from making a business decision exante about whether to undertake competitive activity and risk capital.

So, Bob concedes that step four is a crap shoot, if you get to it, I think steps three are a crap shoot, too, because we're going to be rummaging around in files looking for sound bits from sales executives memos and the like if we're going to embrace an intent base approach to all this.

So, to me, I'm very attracted to Mark Whitener's idea that just carve out the idea of a unilateral unconditional refusal to assist a competitor. Many of the cases that are going to be litigated won't be that simple, but if we had agreement on that, as a very clear, crisp proposition, it would certainly be helpful in terms of how the case would be analyzed thereafter.

IMS Health and IP, there's some different things there, I think that, you know, maybe a copyright was recognized in a system that shouldn't, but I really do think that if you're going to grant an IP right, which should provide very great certainty, and then leave the door just a little bit open to analyzing case by case

whether enough effort was put into the innovation, that can't be a sensible way to run an IP system.

So, if there's a problem with the IP system, maybe that needs to get fixed, as a better way to approach those sorts of situations. Thanks.

MR. McDONALD: Thank you. Steve?

MR. SALOP: I guess I want to make three comments. The first is that I heard a lot of criticisms of intent tests, but no, the sacrifice standard, the NES standard is inherently an intent test. It's just an intent test that doesn't work -- that doesn't quantitatively, but does it in an objective way. That it's fundamentally an intent test, we're trying to figure out whether the sole purpose of the conduct was to generate monopoly power.

With respect to balancing, I find I have to disagree with Bob, it's not trying to -- it's not some sort of social balancing adding up the social debits and credits. What it actually is is trying to figure out the effect on consumers, and I think that's different, because it's more -- it is something that is more objective.

For example, just like in mergers, you do balancing efficiencies and -- efficiency effects and market power effects, but in the end, the question is:

Is the merger going to raise prices? And so I wouldn't call it -- act as if it's some kind of open-ended balancing, it's something that's really fairly objective.

The general criticism that balancing tests are a crap shoot, you know, there are balancing tests all over the law. All over the place. And a generalized criticism that courts aren't good at balancing, well, that's pretty much what courts do. In negligence cases, in first -- in due process cases and so on.

Finally, don't do this at home, Mark said, whether or not we do it at home, we shouldn't let the Chinese do it.

(Laughter.)

MR. SALOP: In the end, this don't do it at home argument always comes down to saying you want to eliminate the jury system, and/or generalist judges. And, you know, if you think that antitrust is beyond the capability of juries, and you want to get Congress to change the rules or amend the constitution, and have it all done by an expert agency, like the FTC, well then go after that. That's an issue of throwing the baby out with the bath water. If it's a problem of the juries can't do it, then get somebody to make the decisions that are good at it. And just like if antitrust isn't

up to the task of maintaining competition or economy, well then maybe we have to go with regulation, but you have to solve the problem in a way that's tailored to what the problem really is, not some other problem.

So, for example, dealing with a -- if you don't like the law, the issue is change the law, don't change the standard itself, and that would be another example of something that the courts might do. I say the way to make antitrust coherent is that another 30 years from now we don't make fun of the dark ages now is to make sure that the rules make logical sense, rational economic sense, not just the goal-oriented to solving the problem of higher prices.

MR. WALTON: I guess I'm still worried about the remedy in the Hughes case and I go back to the testimony for 19 years the Commission tried to get us to sell these crash parts to all vehicles and customers, at the same prices, terms and conditions of sale, this is their words, said prices to be subject to reasonable cost justified quantity discounts and documents. We argued for 19 years on what that meant. We have very good economists, excellent economists at the Federal Trade Commission, we had economists elsewhere and we could never come to an agreement as to what that meant.

The Commission finally 19 years later said they

didn't want to have anything to do with it. They said they didn't want to "commit extensive resources to redoing GM's interpretations to whom and what price it should sell its crash parts."

The other thing is, why do we have a dealer list? One of the major reasons we have a dealer distribution system is we don't know what the price should be. That's a subject between the dealer and the dealer's customers and the region in which the dealer operates. It depends on the trade-in analysis the dealer gets on the car, that's part of the price, it depends on financing, insuring, there's no way that we in Detroit, folks in the central office, can tell the dealer what price to charge for its products.

And then how, if we didn't do it, how can someone in the court, the jury, or the government figure out what the prices should be? That just goes to, I think, basically the onus that debate has been won and lost on what's been more effective, central planning or decentralized markets, and it's decentralized markets that we're trying to take advantage of in our dealer distribution system. That's it.

MR. WHITENER: Okay, well, on the Chinese point, I think what I'm trying to say is when we say to them don't do it, we're essentially saying, do as I say, not

as I do. So, I don't think it's credible if we say don't do it if we're doing it.

On the sort of regulation point, taking a point that Bob made, sort of a general sense that you don't want to slam the door on the rare case that might be meritorious. You put that alongside Steve's concern that if we withdraw antitrust from the field, we're inviting sort of massive direct regulation that we might -- and we might, you know, regret. It seems to me that if you put those two together, the instances when real intervention to force some holder of a bottleneck, or a dominant standard that's durable, the instances when that's really going to be in the public interest are going to be rare, and my point is that that's something that antitrust is not really set up to do.

So, if you encounter one of those situations, to Bob's point, when you haven't slammed the door on the government's ability to exercise the power to take, or to regulate. But that's the proper way to do it, because that's in essence what you're doing, not really applying the antitrust standards that are going to be applied to other types of cases.

MR. McDONALD: Thank you. We have developed a list of propositions that we would like to get the response of the panelists to, both in terms of

determining whether there's a general consensus or perhaps a widespread disagreement on these propositions, and also to get their more in-depth views on these particular points.

Let's start with one on the essential facilities doctrine as distinct from the refusals to deal more generally. Could I have by show of hands from the panel whether they agree with the proposition that courts should abandon the essential facilities doctrine.

MR. SALOP: Could you define essential facilities doctrine so we know which one you're referring to?

MR. McDONALD: That is actually a question that I've got for the panel, so if you want to abstain for the moment, let's see the hands --

MR. SALOP: I'll abstain until I find out what the doctrine is.

MR. McDONALD: Those who agree with the proposition. Very good. Bob Pitofsky, it would be helpful to know from you as one of the proponents of a rare essential facilities doctrine is what does it mean, and is there a requirement, or do the general requirements of Section 2 apply when you're bringing an essential facilities claim? Do you, for example, have to show the representing competitive effect?

MR. PITOFSKY: Well, I think that if you sum up the four qualifications in MCI, which virtually every lower court adheres to, then you, in effect, you have found an anticompetitive effect. And the four I believe was: This only applies to monopolists, it must truly be essential, you can't compete without it, and therefore if the monopolist doesn't make it available, it won't be in the competition. The monopolist has requested and denies making it available, and -- oh, and that it's feasible to make it available. There aren't any chemical engineering business reasons why it can't be done.

If all of those circumstances are true, and they will rarely all be present, then it seems to me that allowing the monopolist to charge any price it chooses up to the point where substitute products can become available, is not a good idea. You're better off cautiously making essential facilities doctrine actual.

MR. McDONALD: So, your point is at least under the first two elements of the MCI test implicitly incorporate the rest of Section 2?

MR. PITOFSKY: I think so.

MR. McDONALD: Is there anyone who wants to disagree with that and say we ought to demand more for any sort of essential facilities case?

MR. KOLASKY: I'll take the bait, I think you should do that, because the first two, as I understand those requirements, is simply that the monopolist has an essential facility, that it owns and controls an essential facility, and that it has a monopoly, and that the plaintiff is going to -- or the rival is not able to duplicate that facility. I think if you allow the essential facilities test to be imposed on that basis, then you really are in an area where you're going to have compulsory sharing in lots of cases.

And I guess one question I would like to turn and put to Bob, as an advocate of the essential facilities doctrine, is: Would you apply the doctrine in cases of intellectual property, because there, when you're talking about patents and copyrights, it's going to be rare that the defendant would be able to show that it's not feasible to make the essential facility available?

MR. PITOFSKY: That's a good question, and the answer is that I am not sure it does apply with intellectual property. I think that's where the case law now is.

MR. McDONALD: Steve Salop, did your fellow panelists answer your question or would you like to yourself pose what the essential facilities doctrine

ought to look like?

MR. SALOP: Well, I set out my -- I set out my standard, I think in cases where it's a really big monopoly, you know, I mean, you know, I -- the first couple of MCI prongs or about monopoly power in the two markets, so I would say in the situation where it's a really big monopoly and in a very important market, then maybe it will weaken the plaintiff's need to show as much anticompetitive effect, and you use my prong two test as a way to determine the rate that's pressed, and that would be the way to handle it. You would have to worry there about incentives, and I think you would, but yeah, I think it's -- I think it is something that we should do where it's a really important monopoly.

You know, there's a lot of markets where normally, take Trinko, something like Trinko, that you say, oh well, the regulator is going to get it. But, you know, it's an accident of history that this industry has been regulated and say operating systems are not being regulated. So, the question is, what do you do where you have like a big monopoly, if this was -- if the FCC had made the decision 25 years ago to include operating systems in its jurisdiction and it had held up with the courts well then, you know, the case in Europe that, you know, some of the prongs in the case here

would have gone to the FCC and we would be in a situation like Trinko. They would have made a decision of whether or not Microsoft had to "share," had to give access to the information that they wanted in Europe to the APIs or to look into the operating systems of someone here. But Microsoft turns out not to be regulated. Nobody took on the task of regulation.

So, the question is, should the court take over the regulation, and I agree there is regulation, should the court take over the regulation when nobody else is doing it, or where the company otherwise isn't regulated. I don't see why not. You know, it's not as if courts never do that. Gas prices have been regulated since 1950, for example. There are little places where district courts are acting like regulators. They're extreme, I agree they're extreme, and they're rare, but it's not to say that it should never be done. And I don't think that's all Bob is trying to get at by preserving the essential facilities doctrine for extraordinary cases.

MR. McDONALD: Hew, do you have a comment on the implication of applying the essential facilities doctrine in the intellectual property area?

MR. PATE: Sure, I would say before that, I don't think it's an accident of history that some of

these cases occur in situations where the State had previously put a firm in a monopoly position and tried to interfere in the first place and the law is trying to introduce competition. I don't think it's an accident.

As to IP, yes, I think the interesting thing about the MCI, the four-part test, is it would be a very good way to describe exactly what the patent system is trying to incentivize, and the paradigm of the most valuable patent that produces something brand new that's extremely valuable, that nobody can duplicate, and we have a patent system that says, in order to incentivize that, you ought to have the exclusive right to it. And it just can't make sense, in my judgment, for antitrust then to come along and second guess that.

We're seeing that now in Europe, where the question is on the table whether it was sufficiently innovative intellectual property to be protected in the trade secret realm, for example, and I think that's just a very disorderly way to go forward, because it damages the predictability on which businesses rely to commit capital.

MR. McDONALD: Thank you. Steve, did you start to respond?

MR. SALOP: I just wanted to make a footnote to what you said. I mean, the court didn't create the Ma

Bell monopoly, the Ma Bell monopoly got created by a series of mergers and certain conduct that was declared not to follow antitrust laws. It was not as if the government said all of these competing telephone companies can merge.

MR. PATE: No, but there was a state sanctioned local loop monopoly in place was what I was suggesting. Not that -- not that the court ordered the creation of a monopoly.

MR. SALOP: Well, they didn't disagree, they didn't break up the operating companies 80 years ago. They didn't. It's not like they made them do it. They committed.

MR. PITOFSKY: Just one line. Look, the fact is lower courts have mandated access in situations where intellectual property was involved, and I didn't notice that it asked for investments or anything on patent work or intellectual property followed that, but I have to agree with you. The essential facilities doctrine runs head on into the very purpose of the patent system, and underlying that purpose, when the patent system is out of control, and this is for a different panel, but it's just, it leaves you with a feeling that essential facilities wasn't designed to do that.

MR. McDONALD: The last comment, Bill Kolasky?

MR. KOLASKY: I guess I will make what I call the Robert Bork point, and that is that all of the discussion so far has been about policy reasons why you should or should not have an essential facilities doctrine. There really is a more fundamental point, and that is the language and the congressional intent underlying Section 2. Section 2 is designed to prohibit affirmative conduct that is designed to gain a monopoly through improper means. And I don't think that you can use Section 2 to impose an affirmative duty on someone to share, unless they have taken affirmative acts to acquire or maintain their monopoly by improper means. Simply not sharing is not an affirmative act. I mean, you contrast that to the affirmative acts that were taken by Aspen Ski Co., which went beyond a simple refusal to deal.

MR. WHITENER: Right, and that was essentially the comment that I was trying to make, there's no essential principle, once you declare that retaining is maintaining. Yes, we can understand how the English language can be used if I say that I take steps to retain my rights and not share them, I'm maintaining a monopoly if there's a monopoly on the product. But that's semantics. That's the point I was trying to make.

A minute ago Steve said I thought basically that it's an accident of history that some segments are regulated and some aren't, and therefore some courts should and do step into those voids where the lack of regulations occurred. I think if I understood it right, that's a fundamental -- well, I don't agree with that idea of the political system, the regulatory act is conscious, a lack of regulation is the result of a judgment at some level of the political administrative system, that there's not going to be regulation, and my point is that those -- it's in the political process where decisions expressly to regulate a particular sector, to re-allocate resources, to take to cap prices, et cetera, those should be made in the political process, not where courts decide that a failure to regulate is a mistake.

MR. McDONALD: Very strong points. Shall we move to the second proposition?

MR. ABBOTT: Yes, the second proposition is the antitrust laws should never require a firm to deal with a rival. Who agrees with this proposition?

MR. PITOFSKY: Wait, wait, wait, what does it mean? Does never include remedy law? That after you found a violation on some basis, remedy is mandating the theory?

MR. ABBOTT: Let's stipulate, I'll say, that we have not found an antitrust violation and assume as part of a remedy certainly that's been required and so let's stipulate that's not included in the statement.

MR. KOLASKY: So you're assuming this is a liability question?

MR. ABBOTT: Right, so this is a very broad question, that the antitrust laws should never require a firm to deal with a rival.

MR. SALOP: We each answered this question already.

MR. ABBOTT: Well --

MR. WHITENER: If a refusal is unconditional, I agree with the statement.

MR. ABBOTT: Is there anybody else who would say if the refusal is unconditional, they agree with this statement? Mark and Hew?

MR. PATE: Unilateral and unconditional, I assume you're meaning.

MR. ABBOTT: Unilateral and unconditional. Because clearly if you add conditional, then the conditions can mimic, you know, tying, exclusive dealing, other arrangements. So, clearly, good point. So --

MR. WHITENER: And Bob makes a good point, too,

excepting other situations where you're recommending a merger.

MR. ABBOTT: Right. Sure, sure. So, I think the panel has ably pointed out that the statement was --

MR. SALOP: I have a question. I have a question. On this word unconditional, if two companies go to the monopolist and they both want to buy the input and one says -- and he says why do you want it? And one says I want it to enter a market and compete with you, and the other says I want it to put on my coffee table, and he gives it to the second but not the first, is that conditional or unconditional?

MR. WHITENER: He doesn't give it to the firm who says he wants to buy it to compete with you, right? That shouldn't be unlawful. There's no condition whatsoever.

MR. SALOP: I'm sorry.

MR. KOLASKY: There is a condition. I will not sell it to you unless you agree not to sell it to me.

MR. WHITENER: No, I'm not going to sell to somebody who is a competitor or who is going to use the product to compete with me. That's --

MR. SALOP: Can I just get where you're going? If he says I'm not going to sell to anybody unless he agrees not to compete. Is that legal?

MR. WHITENER: No, that's illegal. Let's put it this way, if you want to call the fact that it's a competitor a condition, I'll grant that. I don't think I'm going to grant anything else, but I'll grant that. If you want to say that the fact that --

MR. SALOP: I don't believe that you still believe in so much in RPM law. I mean, here we are in the thick of Parke-Davis versus Dr. Miles, this is --

MR. WHITENER: No, I think you're distinguishing between agreements and unilateral practice is important in a lot of settings, including this one.

MR. SALOP: So, if he has a history in which 5,000 people have asked him to sell, and half of them don't compete and they get it, and the other half which did want to compete, who said, just stupidly said to the guy, when they asked for the product, that they were going to compete, he said no to them, but you would not infer that illegal agreement?

MR. WHITENER: Not illegal for the firm --

MR. SALOP: Should it get to the jury as to whether there was an agreement or not or is that as a matter of law there was no agreement?

MR. WHITENER: It didn't sound like agreement evidence to me just now, but --

MR. PATE: Do you, Steve, feel that field of use

restrictions and licenses should be subject to antitrust scrutiny? IP licenses, patent licenses? I mean?

MR. SALOP: Subject to the other conditions of my rule, but there can be an argument that IP has got some special place, you know, I could imagine the Supreme Court could make that declaration, but, you know, the thing, very few refusals to deal would be actionable under my view because very few people have the requisite monopoly power in the two markets, but, you know, this constitutional question of whether IP is different, until the Supreme Court decides it, I'm not going to decide it, I'm not going to argue IP.

MR. ABBOTT: I think there's also, we've probably spent a lot of time on IP and I'm sure it will rise again. There's also statutory construction questions regarding section 271 of the patent act which raises questions about whether that section should be construed as applying to antitrust or just to so-called patent misuse.

But let me move away from IP for a second and relatedly ask what is the difference between charging a price higher than a buyer is willing to pay, and refusing to deal? One can imagine offering to deal at an infinite price is tantamount to refusal to deal, but what if you just say, okay, I'm a monopolist, have a

right to charge my price, and a potential competitor says, well, this is just way higher than I'm willing to pay. Bill?

MR. KOLASKY: You know, one of the problems I have with -- one of the problems I have with a lot of these questions is that antitrust is necessarily a very fact-specific field, and it's one of the beauties of the common law approach and the rule of reason. And, so, I think it's very hard to answer these questions in the abstract without knowing the facts of the particular case. You have a case such as the MetroNet decision in the Ninth Circuit which was decided on remand after the Supreme Court's decision in Trinko, where prior to Trinko, the Ninth Circuit had held that Quest had to make Centrex features available to a reseller at a price at which that reseller would be able to resell those features profitably.

On remand, the Ninth Circuit realized the error of its ways, which were particularly clear in that case, because you had dozens of other resellers who were able to compete profitably, buying the features at the price that Quest was willing to sell them to this reseller.

So, my point is simply, you have to look at the facts of each individual case, and I don't think you can answer it globally.

MR. ABBOTT: Anybody want to elaborate on that?

MR. SALOP: Well, I'll just say a word on it. You have to distinguish between bargaining failure and an anticompetitive refusal to deal. I think that's the issue we're getting at. So, you know, aside from everything else involved, that might have just been the defendant's posted price, and he might say that's the price I posted and I might be open to negotiate and the plaintiff never even offered me a price, didn't make a genuine offer. And I think that the plaintiff should have to make a genuine offer over and above the, you know, the compensatory price.

MR. ABBOTT: Hew?

MR. PATE: I don't think that that distinction is going to hold up in practice, and I do think, Alden, that it is very difficult to draw this boundary. It has been understood, I thought, that American antitrust law does not tell the monopolist that it is unlawful to charge the monopoly price. That's a difference we have with the Europeans, where under article 82, it can be an abuse to charge a high price. That is of why it's so hard categorically to tell Europeans under their system that what they're doing when they look at compelled sharing is fundamentally inconsistent with the principles of antitrust. I think it is fundamentally

inconsistent with an important principle of antitrust here.

MR. SALOP: I guess that the refusal to deal approach, then, that I'm taking and a lot of other economists have taken is the situation where the firm is trying to charge a price above the monopoly price, and that's -- so, you know, what it's saying is that it's a sacrifice of profits in some sense in order to achieve and obtain --

MR. WHITENER: See, what's not clear to me is where the sacrifice is, if I'm charging the profit maximizing price for me. You know, at some point I can set a price that fully compensates me, not only for what I think Steve calls the monopoly price, but the exclusionary price. That is the price of not having somebody else take this product and compete with me with it. I think I'm entitled to charge that, and I think what's being proposed is simply a scheme to regulate the monopolist pricing, but at a level called something like an exclusionary price, rather than the monopoly price. It's still essentially third party intervention saying we're going to decide what price the monopolist can capture for its profit.

MR. WALTON: I guess I have a problem with how do we get this pricing? I just, first of all, what if

it is a false positive? Then I'm not really a monopolist. What if we're misidentified as a false positive. Even if we identified you correctly, who's going to set this price? I just told you it's very, very difficult for someone, even in our position in Detroit to set the prices, let alone someone else. So, I worry about this stringently.

MR. ABBOTT: Okay, I suggest we move on to the next question.

MR. McDONALD: A firm can refuse to deal with its competitors only if there are legitimate competitive reasons for the refusal. The burden of coming forward with legitimate competitive reasons has been imposed on the defendant. Who agrees with this proposition?

(No response.)

MR. McDONALD: Not even Bill Kolasky on the step-wise approach?

MR. SALOP: It doesn't say whether they have monopoly power. It doesn't --

MR. McDONALD: I would think that would -- I would bet that would be implicit.

MR. SALOP: Are you thinking whether we think that Kodak was rightly decided? Is that the question?

MR. McDONALD: No. Steve?

MR. SALOP: Actually the opinion of the Supreme

Court, yes, I thought that opinion was rightly decided, I thought the Justice Department and Kodak took a really extreme position, and, you know, killing their argument was like shooting fish in a barrel.

MR. PITOFSKY: Disclosure.

MR. SALOP: And I could write the brief.

MR. PITOFSKY: I do, too, think Kodak was right. This was the famous footnote that caused a lot of people to be upset. And I don't believe any subsequent case has taken that footnote as accurate.

MR. McDONALD: Very good. Bill Kolasky, on the subject of legitimate reasons, you directed us to consider macro reasons, macro justifications, such as the defendant's -- a defendant wanting to maintain incentives to innovate, a defendant wanting to recoup the investment it's made in the innovation. As a practical matter, how would a defendant go about proving that?

MR. KOLASKY: I don't think that you need proof of that, in an individual case. The analogy I would use is to the law in the area of conscious parallelism, where one of the reasons why we don't allow conscious parallel pricing behavior to be attacked under Section 1 is because it is perfectly natural competitive behavior. It's the kind of behavior that you would expect of a

firm in an oligopoly market.

Similarly, you would expect a firm, including a monopolist, that spends good money developing new facilities, inventing new products, in order to gain a competitive advantage, to want to use those products and those facilities for that purpose. And that is a legitimate business justification in and of itself. I don't think it requires further additional proof. I think the burden is really on the plaintiffs then to show that there is some other purpose underlying the refusal to make the facilities or the inventions available.

MR. McDONALD: That's probably especially applicable in the intellectual property context. Any comments from the other panelists quickly on this point?

MR. SALOP: Well, I gave a quote from Kodak on this about the limits on this defense. You know, I mean, what worries me about it is the proof of competitors could equally not well make this argument. The group of competitors could say, you know, if we can't set the price jointly, we're going to be involved in doing this competition, and we won't be able to make enough money to re-invest and next thing you know the United States is going to lose out to China. And, you know, just antitrust categorically does not -- does not

permit that argument with regard to competition. The antitrust courts are very suspicious of that kind of argument, and I think we should be when a firm makes it as well.

As for these, you know, expectations, Bill said that it's what we expect the firm to do. I mean, I don't agree with that. I mean, we expect firms in the paper industry to collude, but that doesn't mean we let them do it.

MR. PATE: I don't think this comparison to a group of horizontal competitors makes much sense, and courts are pretty well equipped to investigate whether there has been an agreement among competitors. Firms are pretty well equipped to understand that they're not supposed to get involved in that kind of conduct, and so there the law has a workable mechanism to enforce a judgment about whether society is going to be better or worse off with that sort of collusion.

I don't think anybody on the panel would argue that if you had a magic machine that would correctly tell us the consumer welfare balancing answer, that we wouldn't want to impose it. The point is that there is no such machine, and in the unilateral context, there's no way to give firms a basis on which to make decisions about investing capital that is workable when we're

talking about this category of forced sharing.

MR. McDONALD: Thank you. Strong points. Moving to the next proposition.

MR. ABBOTT: Yes, next proposition, and don't ask me to define the language here, because it's Professor Hovenkamp. Herb Hovenkamp, "Condemnation for unilateral refusals to deal should be reserved for situations in which firms have extraordinary amounts of very durable market power." So, extraordinary, very durable, and he doesn't define what it means, but do you agree with his statement?

(No response.)

MR. ABBOTT: So, he's saying here that there should be condemnations in the rare instances, for instance, where there are extraordinary amounts of very durable market power.

MR. KOLASKY: I suspect you have people disagreeing for a lot of different reasons on this one.

MR. ABBOTT: So, does anyone agree with that?

MR. SALOP: Well, if you let me define the words, I could -- I can define extraordinary amount and very durable market power in a way that I agree with it 100 percent.

MR. ABBOTT: Does it make any sense to use those terms which by definition are extremely, one might

argue, open for debate?

MR. PITOFSKY: You could interpret this as an expansion of the essential facilities doctrine, which I'm sure Hovenkamp didn't intend. I mean, it's hard to deal with really vague language like that.

MR. KOLASKY: I was going to make the same point with the flip side of this. I haven't read this particular passage of the antitrust enterprise, but from reading his treatise, I would be -- I would be surprised if he didn't say this in the context of suggesting how the essential facilities doctrine should be limited, and if that's the case, you know, my response is since I think the essential facilities doctrine should be abandoned all together, you know, I suppose if you're not going to do that, I would agree it should be limited in some way and this is as good a way to limit it as any.

MR. ABBOTT: Mark, do you have any thoughts on that?

MR. WHITENER: Actually, I think I tend to agree with what Bill just said. I would eliminate the doctrine, but if you couldn't do that, you know, look for some limiting factors. I don't think this concept, again, going back to my earlier comments, really helps you distinguish as a matter of antitrust policy when you

want to intervene. It's just sort of a directional thing that's saying if the, you know, the impact is great we're going to intervene and if it's not we aren't. But so I think it's better just -- in fact, I think this point illustrates why the doctrine probably isn't very helpful.

MR. ABBOTT: Yes, why don't we try, I think given the inexactitude of the terms here, why don't we move to the next proposition.

MR. McDONALD: This is one that we discussed in the forward, the legality of a refusal to deal should depend on whether the refusal constitutes a change from prior business practices. Hew, you outlined some of the reasons that you thought that that was probably incorrect. Let's see the vote.

(No response.)

MR. McDONALD: Who agrees with this proposition?

MR. SALOP: May I rephrase the proposition?

(Laughter.)

MR. McDONALD: Who invited the economist?

MR. SALOP: You know, economists go through depositions, we know better than to answer questions like this. How about you ask whether the refusal constitutes a change from prior business practice is a relevant fact, agree or disagree. Would you accept that

rephrasing?

MR. McDONALD: I'll accept that amendment. What's the vote? Hew, do you think it's not relevant?

MR. PATE: I'm on board for the idea that if it's really unilateral and unconditional, I wouldn't ask, but is it a relevant fact, I mean I guess that describes the current state of the law, and similar to Bill's answer, if we're going to get into this enterprise, I would make it a relevant fact instead of a dispositive fact. So, I guess I would go with you that far.

MR. SALOP: What if you were not sure whether it was conditional or unconditional? Would it be relevant then? Because you're never sure whether it's conditional or unconditional.

MR. PATE: The way I say it in the written paper, do I believe it's relevant, it does provide some benchmark, it gives some indication that there was a price at which one time there was a willingness to deal. I'm not sure that I see why it's relevant to whether -- just deciding whether something is conditional or unconditional or that I would use it as sort of a tie breaker if I wasn't sure.

MR. SALOP: Oh, no, no, I agree with you, it doesn't tell you anything about whether it's conditional

or unconditional, but if you want per se legality for refusals to deal that you know are unconditional, but it's potentially actionable if you knew it was conditional, then you've got two prongs, you've got two issues now, and so the threshold question would be is it conditional or not, and once you've answered that, you would know where to go.

So, I'm just suggesting what if you weren't sure whether it was conditional. You know, you're going to have to have some burden of proof to define at some threshold on what defines conditional, and so if there's some uncertainty about that, that might take you a step further and then this would be relevant.

MR. PATE: Yeah, I'm not sure I agree that there's a connection. Again, I think the relevance is that if you were in a situation where the court is going to get into policing a duty of forced dealing, then it is true that prior practice gives you a starting point where the complete absence of prior practice doesn't, but that's the best I'll say for it.

MR. McDONALD: Bob?

MR. PITOFSKY: I think I -- look, this is a response to arguments that the defendant might make. The defendant might say, it's not feasible for me to make this particular service or facility available, and

the answer is you used to do it, why can't you do it now? Well, the defendant might say, we'll never figure out what a fair price is if you mandate the price, and the answer is, well, you seem to have come up with a fair price before. In that sense, it could be a factor. Is it really the heart of the matter, is it dispositive? I don't think so.

MR. McDONALD: Don't you think, Bob, that in Aspen and in Trinko's characterization of Aspen, this was a liability factor?

MR. PITOFSKY: The court made a fair amount about the Aspen, I -- I wouldn't do it that way. The fact that it's a departure from my entire business, it's one factor among five or six others, and I wouldn't even make it high on my list of factors.

MR. McDONALD: Okay. I'm getting strong endorsement of this.

MR. KOLASKY: Can we just follow up on that. And I think Aspen really illustrates the problem very well. You know, I agree completely with Bob. I think it's a relevant factor, but by no means a dispositive factor. I think what the court found particularly relevant about it in Aspen was that Ski Co. had entered into the multi-mountain pass at a time when the three mountains that it later owned were separately owned.

And, so, you know, there was a belief that a basis for concluding that in a competitive market, you would have a multi-mountain pass that covered all of the mountains in that particular area, and the same was true at other areas around the country where there were multiple peaks, including ones in which Ski Co. operated, so there was a good basis for the court to believe, and infer, that it was a profitable, procompetitive, cooperative arrangement that benefited consumers.

The problem with it in Aspen, if you look closely at the facts, and there's a very good article in the Antitrust Law Journal by Lopatka and Page which could do that, is that, you know, they show that given the way the revenue sharing was done in Aspen, Highlands was benefitting disproportionately to Ski Co., and, you know, I think Steve and I may disagree about the facts of the case on this, you could actually argue that all that Ski Co. was trying to do in that case was to renegotiate the price. You know, there was some bravado in the language they used about making an offer to Highlands that it couldn't accept, but that's the sort of thing people often kind of, you know, overstate and that often engage in when they're in tough negotiations.

MR. McDONALD: Facts are important. Steve, you have a point on this and Tom Walton had his hand up,

too.

MR. SALOP: I was going to say that the Trinko court is all over the place on this, because there was a, you know, a lot of different conduct, as Bill pointed out, in Aspen. With respect to the sharing of, you know, with respect to the joint ticket, that was collusion. So, you know, and indeed they were sued by the Colorado Attorney General for it. So, yeah, in some sense, all they were trying to do, on that part, they were just trying to redistribute cartel profits.

I think what the -- what the part of Aspen that the Trinko court endorsed was not about the four mountain pass, though they talked about the four mountain pass. They were really animated, as I am, about the fact that they refused to sell daily tickets in bulk or indeed at retail to Highlands, even though they sold them to a lot of other people. And that's the part that really showed the sacrifice. And, you know, so the part that's the outer boundary of antitrust, it's not the refusal to sell daily tickets, I would say, you know, which is well within the refusal of the law, but the fact that you find a firm liable for a Section 2 violation for refusing to sell to its competitor.

MR. McDONALD: Tom Walton?

MR. WALTON: I'm not an expert in any of this,

which is why I'm abstaining from most of the questions. One thing that's been addressed partially, I think it's important that if someone had decided that Chrysler had tried the system that the Commission was recommending, that we could somehow have a burden to go back to that failing system.

MR. SALOP: Actually, if you show they failed, it would be important -- but if they succeeded.

MR. WALTON: I think it did in that case, the ALJ, the Administrative Law Judge did take that into account in his decision that there were competitive reasons, efficiency reasons for adopting this.

MR. PATE: And it only took 17 years, 19, yeah.

MR. SALOP: What do you expect in the Nixon antitrust with Muris and Jim Miller. I mean, they were just very slow and much too interventionalist.

MR. KOLASKY: If I can just respond to Steve's point, because one thing that I, you know, Aspen really illustrates how you have to be careful here. The mere fact that Ski Co. was not willing to sell tickets to Highlands at the retail price, does not necessarily show that their decision made no economic sense and was not profit maximizing. If the availability of the four mountain pass diverted a large enough number of skiers from the three Ski Co. mountains to Highlands, then even

if Highlands was willing to pay the full retail price where the Ski Co. tickets had sold, it could be a money-losing proposition for Aspen, depending on how the revenue sharing was done.

MR. SALOP: I agree with that, that's a footnote in my paper, and interestingly, what's really actually interesting about the Trinko court, is they did not balance the losses in the one market against the gains in the other. When they did their profit sacrifice test, they took the very superficial naive approach. They said, oh, you sacrificed profits on the daily ticket, that's it, that's your profit sacrifice. So, really they took quite an extreme position in that.

MR. McDONALD: Thank you. Moving to the next proposition.

MR. ABBOTT: Yes, the next proposition.

MR. McDONALD: It is difficult to craft an injunctive remedy in a refusal to deal case.

MR. KOLASKY: You mean one that works well?

MR. McDONALD: It's really easy to craft one that doesn't, yes, Hew probably agrees. Everybody agrees. Steve, yours is difficult enough. Bob Pitofsky, you've said that you thought that one reason that it was appropriate to have refusal to deal liability is that the defendant would get a reasonable

royalty from the remedy. How would you calculate that reasonable royalty?

MR. PITOFSKY: Well, it's hard to generalize. I mentioned two examples, one is that you previously have been dealing with people and charging them a royalty, and you know, the first thing I would do is say to the parties, why don't you try to work it out, and come back to us with a proposal. And they come back and say we can't work it out and you say, I'm going to refer it to arbitration. And then the arbitrator comes back and comes up with a number. Presumably that will work most of the time. And if neither one of those approaches work, you get some expert economist to come in and argue with some other expert economist and you come up with a reasonable number. Look, we all voted, it's very difficult, the most difficult part of this whole area to accomplish, but it has been done, it can be done, and the price is not, I think, part of it.

MR. McDONALD: Steve, is your formula one that can be applied by a jury in district court?

MR. SALOP: With expert economists and good lawyers, yeah, I think so. I think it can be proved.

MR. McDONALD: All right, we'll move on to the next proposition.

MR. ABBOTT: Next proposition is that an

intellectual property owner's unconditional, unilateral decision not to license technology to others cannot violate the antitrust laws. Again, this is that the unilateral, unconditional decision not to license technology to others cannot violate the antitrust laws. Who agrees?

MR. PITOFSKY: That's what the law is.

MR. ABBOTT: All right, one, two, three, four. Who disagrees?

MR. SALOP: I don't agree.

MR. ABBOTT: Steve Salop abstains and Bill Kolasky disagrees.

MR. KOLASKY: Can we explain why?

MR. ABBOTT: Yes, explain why you disagree, Bill.

MR. KOLASKY: Again, I'm going to keep coming back to the common law nature of antitrust. Suppose the fact pattern similar to what you had in MCI and AT&T but involving intellectual property rights instead of interconnection. A patent owner knows that rival A is thinking about investing in R&D to develop a competing technology, and so it strings A along, promising to license it, but in fact, playing rope-a-dope with it, delaying it, in order to discourage the rival from investing in its own technology. I would think in those

circumstances, you could hold the refusal to license to be an antitrust violation.

Again, it's not a simple unconditional refusal to license, but there's a pattern of conduct that is having an anticompetitive effect.

MR. WHITENER: I think that last point is important, it's outside the context of unilateral, unconditional behavior. You have something else going on, whether that's something that would be an antitrust violation, I don't know, but now you're describing something else, and I think it's very, very important and useful to always come back in these cases to what it is we are looking for and separate out conduct of what you described by the simple decision to obtain the property one's self.

MR. PATE: And you probably plead the elements of fraud in the way you described it, right, so it's an open question whether that needs to stay an antitrust claim before you can prove the wrongful behavior.

MR. SALOP: That's what the Microsoft cases and the Telecom cases that all of these allegations are still rolling in the negotiations and, you know, they were elements.

MR. ABBOTT: Should one distinguish between patent licensing, let's maybe soften the unconditional,

in other forms of intellectual property licensing, such as trademarks. For example, trade secrets, is there a reason to distinguish among forms of IP?

MR. PATE: I would say as long as they're defined correctly, if there isn't a problem with the underlying IP system, the answer probably is no, that there shouldn't be a requirement to license any of those, as long as they're performing their proper function, and I think you have to give a conclusive promotion of correctness to the IP system in doing so, and then turn to IP reform as the way to handle it if the IP system isn't. Otherwise, you have this collision that defeats the purposes of both bodies of law.

MR. ABBOTT: Anyone disagree, or are we all of a common mind here?

(No response.)

MR. ABBOTT: Okay. Well, let's move to the next proposition, which is compulsory licensing of IP as an antitrust remedy should be rare. Now, probably we should distinguish between remedies in different sorts of cases here, but first I would like to get people to vote on this proposition as a general matter. Who agrees?

MR. PITOFSKY: Yeah, I agree it should be rare.

MR. KOLASKY: Are you taking merger out?

MR. ABBOTT: Well, that's why I said we should distinguish between all the forms of situations in which remedies arise.

MR. WALTON: In a merger case, it could be the least restrictive, most effective remedy in some cases. If it was a remedy for a unilateral, unconditional refusal, you shouldn't be doing it in the first place.

MR. ABBOTT: So, what you're saying is that this decree depends upon the facts, and certainly we've seen a number of major cases in mergers in which IP was very key to the merger, in which compulsory licensing was required. How about the nonmerger context?

MR. PITOFSKY: Let me just in the merger context, the leading example is Ciba-Geigy where the Commission allowed the merger to go through on the condition that a basket of intellectual property rights were divested to a third party. And as that's the one time that I think Business Week said that the government finally got something right. So, it can be a least restrictive alternative can be the best way to go. Does it come up a lot? It has been known to come up.

MR. ABBOTT: Okay, I think this question has raised fewer sparks than some of the other ones, and let's see if the next one generates some sparks.

MR. McDONALD: This one is tailor made for Tom

Walton. A manufacturer's refusal to deal with independent service organizations should not violate the antitrust laws.

MR. WALTON: Yes, I would be all for that. I would say in Kodak, General Motors, there's two -- there was a -- I'm not an expert in Kodak, by any means, I've read it briefly, but apparently there was a distinction between whether Kodak was going to impose this refusal to deal on manufacturers that already had their copy machines, that was one issue. But the other issue was whether it would be going forward, whether it would impose -- it did not do that, it did not do that, first thing.

The second thing it did was impose this restriction on companies like General Motors that were going to buy the machines, or bought a new machine, then they would have to use only the parts provided by Kodak or not use the independent service organization. You have the right to not enter into that agreement.

So, the Kodak market was a competitive market, so I don't see any -- I may be wrong, but I just don't see any problem with that situation.

MR. SALOP: That case was not the first situation.

MR. WALTON: Oh, was it? I may stand corrected.

MR. McDONALD: By a show of hands, who else is willing to share Tom Walton's is unconditional endorsement to this proposition?

MR. PATE: If the question is competitive upstream market, would you have agreed with the Kodak result, I would say no, so I think I would raise my hand on that.

MR. WHITENER: Same.

MR. McDONALD: Do any of the panelists care to speak on the circumstances in which refusal to deal with an ISO definitely should be an antitrust violation?

(No response.)

MR. KOLASKY: Again, I think what makes it difficult is the qualification that Hew put on his answer, you know, if you had a situation like Kodak where you had a competitive upstream equipment market, then it's hard to imagine the circumstances in which you would find a refusal to deal with an ISO unlawful. But what if you had the circumstance where you had a monopolist upstream who is refusing to deal with ISOs? Again, I think as a general matter, there's a strong presumption that it's not unlawful, but if the plaintiff is willing to show facts that show that it was a part of an anticompetitive pattern of conduct that was designed to maintain or expand your monopoly, then it could be

unlawful if there are not legitimate business reasons for it.

MR. SALOP: I would not use the distinction Bill did, but rather I would ask whether it was a change in conduct such as it was a monopoly, so if even a monopolist from the get-go says you have to deal with me, that would be okay, but the question is, you know, the Kodak case was about the change in conduct.

MR. KOLASKY: But another situation, normally you think that the markets for ISOs are relatively easy to enter, and that therefore a refusal to deal with ISOs is not likely to raise entry barriers, but suppose the plaintiffs were able to show that the reasons the monopolist was refusing to deal with ISOs was to make it more difficult for somebody else to enter the equipment market, and thereby break down their monopoly. On those facts, then I think you might have a basis for liability.

MR. McDONALD: Thank you. We're going to move now to a couple of hypotheticals.

MR. ABBOTT: Okay. The first hypothetical raises a question of IP, and let me read it: Ajax Company holds a patent (patent X) over a small part of a device that provides a new broadband service far superior to any alternatives. There are no acceptable

substitutes for that patented part; without it the new broadband service cannot be deployed. Firms holding all patents covering all other essential parts of the device have entered into a patent pool that sets a reasonable royalty. Under this all third party businesses may obtain a license. Ajax, however, refuses to license patent X to anyone, thereby preventing third party companies from having any access to the part that is necessary to be able to provide the welfare-enhancing broadband service."

Well, again, this is a small component of a larger device, but by holding the patent and refusing to license the patent for that one component, despite the fact there are many other components, in effect, Ajax is able to prevent any other firm from launching the broadband device, and the broadband service that depends upon the device. First of all, does Ajax have an absolute right not to license patent X?

MR. WHITENER: I mean, I think it does, but I'm not sure in the hypothetical yet really if I understand what Ajax is doing. I don't particularly care, because I don't think I'm going to condemn their decision to sit on their patent, but what are they planning to do to make money? Are they going to invent some other way to do the broadband service? If they're just trying to

stupidly put the patent in a drawer, I don't think that subjects them to liability.

MR. PATE: No, I don't think that they are required to license the patent, and it really doesn't matter to me whether they put it in the drawer or not. Not because that wouldn't produce a situation wherein that case consumer welfare wouldn't be enhanced by taking it from them, but because of a judgment that a property rule here is going to be superior to a liability rule in producing innovation over the long-term. And if the broadband service is one that's going to cure avian flu or something, then presumably the government can take, and with just compensation, use it if there's some sort of emergency at issue, but otherwise, no, I don't think Ajax has any obligation.

MR. ABBOTT: Does anyone else think it matters, does it matter if Ajax plans to launch a new broadband service itself? We've heard from a couple of people, as opposed to just sitting on the patent, or alternatively, and the facts haven't been presented here, but maybe they have some interest in some other broadband investment, and they find it profitable, at least in the near term, not to have a new broadband service introduced by anyone.

Steve?

MR. SALOP: It would make it a lot more interesting. But Ajax is a client of mine and I don't feel that I should comment. You know, I think that it's what we've been talking about all day. I mean, once you say Ajax has an -- is a competitor downstream, that they've got ISDN, and now this is DSL, then you've got the vertically integrated -- if they're a monopolist downstream, then you basically have the hypothetical that we've been talking about all day.

MR. ABBOTT: Does anybody, and we heard Hew Pate speak directly to this, does anybody believe that the welfare impact on the industries or consumers who would benefit from the new broadband service should be taken into account?

(No response.)

MR. ABBOTT: No one is willing to comment on that? So, you all agree with Hew's proposition that it doesn't matter, and the absolute right not to license? And you don't need to -- you don't take into account any potential welfare effects?

MR. PITOFSKY: I find this very difficult to deal with, because as a practical matter, you have to ask Ajax why? Why are you doing this? What's your role? What are your other facilities? What are your resources? And I know you don't like the idea of

somebody having to explain why, but in a bizarre situation like this, I can't even begin to cope with this hypothetical. Well, what do you mean you want what? Is there no price under the sun that will be enough that this patent pool can induce you to come into the transaction? And depending on what that reason is, then we go forward with, under what circumstances, if any, should the law intervene.

MR. KOLASKY: I'm sort of with Bob on this in the sense that I don't think there are nearly enough facts in this hypothetical to begin to answer the question. I mean, on its face, this sounds like Ajax has simply invented a better mousetrap and it ought to be free to capture the value from that new mousetrap however it wants, and if, for example, hypothetically the members of the patent pool currently have, you know, 100 percent of the market and Ajax is a new entrant, that using this new device as its entry point, then it's perfectly natural that it would want to have a period of time in which it has exclusive rights to that device. It may down the road license others, and in addition its refusal to license may stimulate the others to try to develop an alternative to this new device. So, this doesn't sound anticompetitive on its face. It sounds like competition on the merits.

MR. ABBOTT: Steve, a quick comment?

MR. SALOP: I agree with Bob, and I think stating that in this pristine way, you know, in Aspen, the reason why Aspen took that extreme position that they just had a right to do whatever they wanted, was because they squandered all their other defenses in the courts below. And, you know, in a real world case, unless Ajax just decided to fight this because, you know, their CEO or board members were intellectual property lawyers and they felt it was a good thing just to fight it for the good of the country, they would give a reason. And the reason -- and then the reason is going to matter.

MR. PATE: But the thing that's important is that requiring them to give a reason, in and of itself, is going to generate a tremendous amount of uncertainty in our system of litigation-based decision making. So, you can always come up with a better result in the individual case, you've got to consider what you do to the system when you do that.

MR. WHITENER: Right, and if somebody states the reason bluntly in an email, which is I want to keep others from competing with me in my IP, you know, you might get to trial and you might have liability, even though, beyond repeating myself, all you were doing was

keeping it.

MR. PATE: I don't know which is better, we've had some strain of this conversation that has said that the worst thing would be that if Mr. Ajax is cranky and has it in the drawer, then we're worried about the consumer welfare effects of it not being used, but that if it's being used to get a competitive advantage, then that's good, that's the American way, but, you know, as Mark points out, it may be that if the email says that we're going to use this to stick it to the competition, that's when you have a really protracted litigation.

MR. ABBOTT: Well, let's turn quickly to the last hypothetical, we're going to make this litigation last some more. The final hypothetical is a shorter one, so -- but perhaps ironically has fewer ambiguities than our previous hypothetical. Alpha Company owns the only source of an input (input Z), or if we had an English speaker here, it might be input Zed, and alpha uses input Z to make widgets. Beta Company invents a new technology that uses input Z to make widgets at a lower cost than Alpha's technology. Alpha refuses to sell input Z to Beta, but Alpha does sell input Z to firms in other industries for $100 per unit.

First of all, should Alpha be required to sell input Z to Beta, since it sells to firms in other

industries? Hew?

MR. PATE: Well, and you're eliminating arbitrage, they can't get it from the $100 purchasers for some reason?

MR. ABBOTT: Yes, let's assume that. Yes, I think --

MR. PATE: No, I don't think Alpha has an obligation to sell the input it owns to Beta.

MR. ABBOTT: Anybody else?

MR. KOLASKY: Again, too few patent facts. Does Alpha have a monopoly on the widgets market, are there other ways to make widgets with inputs A, B and C? I mean, you just don't know enough.

MR. WHITENER: I actually think under these facts, I know enough to say no obligation to deal, no obligation if they deal, no obligation to deal at $100, no obligation to deal at Steve's, you know, the monopoly at nonexclusionary price. I mean, look, Alpha owns Z. Alpha has the rights to all the return money on Z, and it really shouldn't matter if Z can be deployed in one antitrust market or 50. It's all the same way of saying Alpha owns, lawfully, I assume, developed Z, it gets every dollar attributable to ownership of Z by exploiting it itself. And I do have a question for Steve, if Beta, with this low-cost technology, assume if

they get the input at whatever, let's say $100, if we can predict that their lower cost widget manufacturing method is going to let them ultimately take most or all the sales of widgets, do they have to share their manufacturing technology with Alpha?

MR. KOLASKY: That's an interesting question.

MR. SALOP: I mean, that's an interesting question. It would depend, is there a monopoly on that technology or are there other makers of that technology?

MR. WHITENER: We are predicting over that, since they get the input at $100, they are going to get all the widget sales because they have a lower cost of manufacturing. And let's assume they can readily license this device to Alpha. Do they have to share it?

MR. SALOP: I mean, I think you have to go through now it's the machinery is an input, but it wouldn't -- so I guess you're saying they have a monopoly on securing your technology, but they may have no market power in the widget business, and, you know, the monopoly power in the widget business, which is what Bill is getting at, is a very important element, not to mention the alternatives to input Z.

MR. WHITENER: I think what would happen if you did conclude there was monopoly power and an obligation to deal, one consequence is Alpha's incentive to develop

a lower cost technology itself is now removed, because they can share, and if Beta gets to buy the input at $100, their incentive to innovate around or replicate Z I think is what is similarly diminished.

So, I mean, I think you can construct a set of facts that says they have to deal with each other and I think you have wound up essentially with the economics of one firm producing rather than two firms struggling to compete with each other.

MR. SALOP: Or the two firms competing. That's the problem with the competitive nature, if they do or not.

MR. ABBOTT: Any additional comments on that hypothetical?

(No response.)

MR. ABBOTT: Well, if not, let just have a few closing remarks, and I think my colleague, Bruce McDonald, may want to say one or two things as well. Let me move to the podium, very briefly.

It's difficult to generalize based on depth and also the comments that were made today, but I think we've heard some interesting discussions and analyses of different aspects of the refusals to deal with competitors. Number one, we have heard alternative forms of multipart balancing tests, some of these tests

have been characterized as really sliding scale, tests that rely on certain propositions, but that don't require a lot of difficult administration. We've also heard some concerns that the problem with any of these tests, and this is going to repeat a theme, that when you go to a jury, will the jury be able, sensibly, to apply them given their, in effect, potentially high error costs. We've heard some responses that, well, no, the juries are in the business of doing that, generalist courts and judges are in the business of weighing, applying weighing balancing tests in all sorts of areas of law.

We've also, I think, heard all speakers, certainly emphasize the theme that facts and hard facts and details are very important, that's certainly come up in the context of propositions we raised and in hypotheticals. There's always a demand, quite understandable, for more details and more facts. I think that all of this, and in particular, the specific written comments and written presentations by our panelists will prove quite valuable as we ponder the record developed throughout the hearings and there are no simple or some might argue there are simple answers here, but certainly there are no -- there is no unanimity of opinion.

Despite that fact, I think we've heard that, and it seems to be a general theme, that imposing a duty to deal on the monopolist is something that is very rare. Some would say that general unconditional impositions to deal should never be applied, others say there's more nuance to that, but I think there's a general understanding that this is a very unusual sort of requirement, and certainly perhaps intentionally with antitrust law and having more to do with regulation, and that brings us to the sort of broader question that over the tension and the dividing line between antitrust remedies and regulation in general, and the ability of courts and expert agencies to administer such tests will remain with us.

And now I would like to turn briefly to Bruce McDonald to see if he has any additional insights to share, and also to thank him and all of the people from the Department of Justice who have helped so much in putting together this session. I would also like to thank all of my colleagues in the Federal Trade Commission, too numerous to mention, who have done a wonderful job in making this session a success.

Bruce?

MR. McDONALD: Let me just add thank you that today's discussion does highlight that even though this

may be one of the most narrow grounds for battle in the refusal to deal -- in the single firm conduct debate, it is certainly one of the most hard fought. The agencies work hard to try to incorporate the latest thinking into their enforcement decisions and these hearings are a part of helping us to remain on the cutting edge. We can't thank the panel enough for the time they devoted to preparing their presentations and for being here and for sharing their expertise for us.

On behalf of the FTC and DOJ, thank you very much.

(Applause.)

(Whereupon, at 5:13 p.m., the hearing was concluded.)

CERTIFICATE OF REPORTER

I, Sally Jo Bowling, do hereby certify that the foregoing proceedings were recorded by me via stenotype and reduced to typewriting under my supervision; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were transcribed; and further, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of the action.

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