Joint Comments of the American Bar Association's
Section of Antitrust Law and
Section of International Law
on the
Commission Discussion Paper on the Application of Article 82
of the Treaty to Exclusionary Abuses (December 2005)

INTRODUCTION

The Section of Antitrust Law and the Section of International Law of the American Bar Association (collectively, the "Sections") appreciate the opportunity to submit these Comments on the *Commission discussion paper on the application of Article 82 of the Treaty to exclusionary abuses* (the "Discussion Paper"). The views expressed are the views of both Sections. These comments have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association.

The membership of the Sections includes more than twenty thousand lawyers. Most are based in the United States of America, but many have lived and worked outside the United States, and a significant number do so currently. Members of the Sections have substantial expertise with antitrust laws in the United States and in many jurisdictions. In addition, many non-U.S. attorneys are associate members of the Sections and have contributed their expertise and perspectives to the Sections' work.

On December 19, 2005, the Commission published the Discussion Paper and invited comments by interested parties. The Sections are grateful for the opportunity to comment on the Discussion Paper and hope that our insights and analysis will be helpful.

Exclusionary practices are a central aspect of U.S. antitrust law enforcement, just as they are at the heart of the important work of the Commission. The Sections are grateful to the Commission for preparing this extensive discussion paper, opening up this important debate and presenting it in a clear and systematic way. It serves a very important role in seeking to provide clear guidance to the business community and private bar, and, thus, more effectively promoting the antitrust rule of law. We recognize that differences will exist between the U.S. and EU regarding our respective jurisprudence and our enforcement institutions. We will point out these differences respectfully and candidly in the interest of promoting the full discussions the Commission desires. As to many of these important issues, there is very clear agreement in our approach and outcome, including the effects-based approach, the equation of dominance with substantial market power, the recognition of the relevance of efficiencies, and the focus on protection of competition, not competitors. Our comments and suggestions endeavor to take these factors in account.

These comments are divided into seven sections: (1) general issues relating to the definition of exclusionary abuse, the definition and proof of dominance, the framework for analysis of single firm exclusionary abuse,[1] and related matters, as addressed in sections 1 through 5 of the Discussion Paper; (2) collective dominance; (3) predatory pricing; (4) treatment of single branding and rebates; (5) tying and bundling; (6) refusals to supply; and (7) aftermarkets.

The Sections appreciate that the Discussion Paper does not set out formal guidelines on the application of Article 82 at this time. We strongly encourage the Commission to prepare such guidelines following the completion of the current consultation process. Guidance in this area would be greatly valued by the business community and the competition bar and would create a standard of consistency that would be of importance as Article 82 is applied and interpreted by national courts and competition authorities in the European Community.

EXECUTIVE SUMMARY

The Sections are in general agreement with much of the analysis in the Discussion Paper, particularly the effects-based approach, the equation of dominance with substantial market power, the relevance of efficiencies and the protection of competition not competitors.

1. Future guidelines would benefit from setting out as clearly and unambiguously as possible the meaning of dominance and of exclusionary abuse. The potential for inconsistency and divergence increases as the courts and authorities of the Member States assume responsibility for the interpretation of Article 82 and, even more importantly, as private antitrust litigation increases. Recent EU "modernization" and the addition of ten new Member States significantly increases the risk of inconsistent application of Article 82 by multiple enforcers and the potential for chilling pro-competitive business conduct. Without clear Guidelines from the Commission, there will be opportunities to interpret ambiguities in ways that limit competition and decrease incentives to innovate. Although we understand the great difficulty of the task, clarity about the meaning of dominance and exclusionary abuse will promote and nurture a dynamic and innovative European economy.

2. We respectfully suggest that the discussion of dominance be expanded and clarified in various respects, notably by making clear that the market shares set forth in paragraph 31 do not create any presumption of the existence of dominance.

3. Productive efficiency and innovation explicitly should be incorporated into the analysis that leads to any finding of exclusionary abuse, and productive efficiency should not be considered merely as a limited affirmative defense.

[1] In the Discussion Paper, the Commission elected to deal only with exclusionary abuses, deferring for the future the analysis of exploitative and discriminatory abuses under Article 82. Our comments, accordingly, are limited to practices within the Discussion Paper's definition of exclusionary abuses, *i.e.*, business strategies that may be predatory or exclusionary.

4. The collective dominance discussion should recognize that mere coordinated interaction (conscious parallelism), without more, is not sufficient to support a finding of collective dominance.

5. A finding of predatory pricing should require a showing of all elements of an abuse, including the likelihood of recoupment. A firm with a substantial degree of market power should not be assumed to be able to recoup. Recoupment may require higher prices than those which prevailed prior to the alleged predation. Where the burden of proof for certain elements is shifted to the defendant, the relevant standard of proof should be the same for the Commission and for the defendant. In addition, there should be no exposure to predatory pricing where the firm's prices are at a level that exceeds its average total costs. The treatment of single-branding obligations and certain rebate systems as, in effect, presumptively illegal (when undertaken by a dominant firm) should be evaluated under either a rule of reason-type analysis or a predatory pricing analysis, depending on the exact conduct at issue. In addition, the analysis in the Discussion Paper would benefit from a recognition of the difference between single-branding obligations imposed on the customers through a refusal to deal and one achieved through incentivizing behavior.

6. The business community and competition bar would benefit from a clear, limited statement of any exceptions to the general rule that undertakings have the right to determine supply relationships. Such transparency would reduce business uncertainty. The continuation of existing supply relationships should not be presumed to be procompetitive; the complaining party should have the burden of showing that the input is indispensable in all cases involving a refusal to supply.

7. The essential facilities doctrine should not be applied to find a duty to deal in the name of fairness to smaller competitors or potential competitors.

8. Although the Discussion Paper appears to limit the circumstances in which an obligation to license intellectual property may be imposed, the imposition of such an obligation to license intellectual property rights should not occur absent proof of a separate violation, such as single branding or tying. Paragraph 240 should reflect the principle that a dominant firm will be required to grant a license only in narrowly-defined circumstances. Also, the discussion would benefit from the discussion of crucial concepts, such as what is a "new product."

9. Trade secrets should be entitled to the same level of protection provided to other intellectual property rights. No obligation to disclose interoperability information should be imposed unless the conduct in question by the dominant company constitutes a violation of Article 82.

10. The Discussion Paper provides a complex, multi-step analysis of aftermarkets. The analysis focuses on a limited concern regarding "installed based opportunism," which is more appropriately addressed through private contracts rather than by application of Article 82 to single-brand aftermarkets.

COMMENTS

I. EXCLUSIONARY ABUSES: GENERAL ISSUES

The Sections welcome the clarity and directives of the Discussion Paper, particularly its:

- clear statement that the objective of Article 82 in relation to exclusionary abuses is the protection of competition as a means of enhancing consumer welfare and ensuring the efficient allocation of resources;
- clarification that the core meaning of dominance for purposes of Article 82 is the possession of a substantial degree of market power; and
- recognition that practices by dominant firms such as exclusive dealing and loyalty rebates should not always, or almost always, be illegal, but that such practices may often have pro-competitive effects, and that economic analysis should be fully brought to bear on such issues.

We believe, as this process unfolds, that the discussion of the criteria for single-firm dominance would benefit from further clarification in the form of new guidelines on Article 82, or in some other form. Moreover, to the extent that the Commission decides to establish an operational definition of exclusionary abuse, we urge that the role of productive efficiency in that definition be made clear.

A. Dominance

The test for dominance set forth in the Discussion Paper is substantial market power, appropriately determined by using well established and sound economics.[2] We suggest that the Commission consider clarifying this fundamental rule in four important respects.

First, consider the analysis of paragraph 31[3] to state explicitly that while high market shares may be associated with "economic strength on the market" (one of the three factors identified in paragraph 21 as germane to a finding of dominance), such market shares alone do not imply dominance, in the absence of paragraph 21's two other factors—prevention of effective competition and the ability to behave independently to an appreciable extent.

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[2] U.S. law has a similar understanding of the core meaning of "monopoly power." *See* IIIA PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶ 800-02 (2d ed. 2002). *See also* ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 230-32 (5th ed. 2002) ("ALD").

[3] The Discussion Paper indicates that market share is the "starting point" for an analysis of dominance, ¶ 29, but interprets a firm's high market share in the context of market conditions, such as whether shares have been stable over time or if the market is dynamic due to innovation and growth. ¶ 30. It notes that, according to case law, persistently high market share, in excess of 50 percent, would very likely support a finding of dominance, "provided that rivals hold a much smaller share of the market." Paragraph 31 says that shares in the 40-50 percent range, or even as low as 25 percent, might support a finding of dominance.

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Many factors in addition to market share may bear on a finding of substantial market power. These include product heterogeneity, entry barriers, the importance and pace of technological innovation, the ability of one competitor to overtake another rapidly through innovation, customer characteristics (sophistication, ability to elicit new supply, etc.) relevant to customer ability to evade or defeat attempted exercises of market power by suppliers, and the existence of downstream competition. Some of these factors are identified in paragraph 28 of the Discussion Paper, but the discussion there could usefully be expanded and made more comprehensive. It would, for example, be useful to refer back to paragraph 27's recognition that price reductions prompted by competitors are generally incompatible with dominance. Moreover, as recognized in paragraph 146 and footnote 92, high market share is not typically associated with dominance in bidding markets for capital goods, where "competitors are competing on equal terms for all the customers and for each individual customer's entire demand."

Second, we respectfully suggest that paragraph 31 make absolutely clear that the market share figures should not be interpreted as a conclusive legal presumption about the existence of dominance. The discussion should make clear that there is no intent to expand the circumstances in which dominance is presumed, beyond existing case law.

Third, the Commission may wish to provide more practical advice to businesses by considering the utility of a market-share-based safe harbor, below which dominance would not be found.[4]

Fourth, some of the analysis set forth in the Discussion Paper incorporates the concept of degree of dominance. *See, e.g.*, ¶¶ 59, 149. The discussion should confirm that the factors identified in paragraph 21 apply in all cases and that even a firm with a

[4] We note this recent statement by the Office of Fair Trading:

> The European Court has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50 per cent. The OFT considers it unlikely that an undertaking will be individually dominant if its share of the relevant market is below 40 per cent, although dominance could be established below that figure if other relevant factors (such as the weak position of competitors in that market and high entry barriers) provided strong evidence of dominance.

Office of Fair Trading, Abuse of a Dominant Position (2004) ¶ 4.18 (footnote omitted), available at http://www.oft.gov.uk/NR/rdonlyres/0620258B-3006-4B1C-ADC6-5CC69E6EF4F1/0/OFT402.pdf.

If this safe harbor approach is unacceptable, then we would recommend that the discussion regarding dominance at shares below the 50 percent level be revised. We note the acknowledgment in paragraph 31 that dominance is more likely to be found where market shares are over 40%, but suggest that the Discussion Paper state more clearly that companies with market shares below 40% will be presumed not to have a dominant position absent special circumstances such as those found in the cited cases. To the extent that a finding of dominance is allowed at market shares below 50% or 40%, the statement that companies with shares below 25% are "not likely" to have a dominant position could also be strengthened. We note that recital 32 of Council Regulation 139/2004 on the control of concentrations among undertakings (the "ECMR"), cited in paragraph 31, states that market shares below 25% will not impede effective competition. *A fortiori*, market shares below 25% are inconsistent with substantial market power, the core meaning of dominance.

very large market share will not be deemed to be dominant where it is subjected to significant competitive pressure by rivals or customers.

B. Meaning of Exclusionary Abuse

The Discussion Paper identifies allocative efficiency and consumer welfare as the key goals of enforcement policy regarding exclusionary abuses and recognizes that such enforcement is intended to protect competition and not competitors, and endorses competition that makes products more attractive to consumers. ¶ 54.

Regarding the concept of exclusionary abuse, the Discussion Paper refers to foreclosure of competitors, injury to consumers (in the short run and in the long run), efficiency, distortion of competition, competition on the merits, and abnormal versus normal methods of competition. *See* ¶¶ 1, 54, 57, 58, 60, 84-92, 94, 127, 134, 144. Further delineation regarding the terms "exclusionary abuse," "competition on the merits" and "normal methods of competition" would be helpful to avoid any ambiguity.[5] Moreover, no rule is given to guide the weighing and balancing of the various factors identified as relevant to a finding of exclusionary abuse.[6]

In the United States, no single operational definition of exclusionary conduct is set forth in the case law. The antitrust agencies have issued no guidelines on the question, and the Sections do not take a position on which, if any, competing test of exclusionary conduct ought to be adopted. In recent comments to the Antitrust Modernization Commission, the Section of Antitrust Law observed that the "core of the debate [over tests for exclusionary conduct] centers on how to find a standard that strikes an appropriate balance between over-deterrence, which would chill legitimately aggressive competitive conduct, and under-deterrence, which would result in competitive harm that reduces consumer welfare."[7] This statement comprehensively outlines the debate over the merits of several tests for exclusionary conduct. The Section's Modernization Commission Comments are attached to provide the Commission with the full range of issues being discussed in the U.S. debate. Many of the same issues are also addressed at some length in the OECD Paper.

Understanding the enormity of the task, we would urge the Commission to include in its definitive guidelines a general operational definition of exclusionary abuse.

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[5] *See* Organisation for Economic Co-operation and Development, Competition on the Merits (Dec. 2005) (OECD Paper), *available at* http://www.oecd.org/dataoecd/7/13/35911017.pdf

[6] For example, innovation by a dominant firm may cause great economic harm to competitors, but may, at the same time, confer great benefits on consumers. As the Discussion Paper recognizes, consumer injury or benefit depends not only on price but also on quality, selection, service, and—crucially—innovation. ¶ 4. Furthermore, we suggest that any determination as to whether consumers benefit from innovation should reflect differences in quality or product characteristics. *See* ¶ 24. Making the adjustment, however, is not easy or simple, in part because different consumers place different values on quality changes.

[7] Comments of the Section of Antitrust Law of the American Bar Association in Response to the Antitrust Modernization Commission's Request for Public Comment Regarding Exclusionary Conduct at 7 (March 17, 2006), *available at* http://www.abanet.org/antitrust/at-comments/2006/03-06/Comments-AMC-ExclusionaryConductFinal.pdf.

Although the Sections take no position on the question of which test to adopt, we urge that three important points be considered in any treatment of the core concept of exclusionary abuse.

First, we urge that productive efficiency be recognized as an important factor for a *prima facie* finding of exclusionary abuse, and not considered merely as an affirmative defense. It should be made clear that steps undertaken by a dominant firm to lower its own cost of production and distribution are "normal methods of competition" and "competition on the merits," and that enhancement of productive efficiency may not be, and normally is not, an exclusionary abuse, even when it harms competitors, enhances market power, and fails to meet all the requirements of the efficiencies defense laid out in section 5.5.3 of the Discussion Paper.

Although there is no recognized formula in U.S. law setting forth how efficiency and innovation are to be taken into account in the finding of unlawful exclusionary practices, there is general agreement among commentators and U.S. courts that conduct associated with product improvement and efficiency-enhancement should not be condemned unless the anticompetitive effects clearly outweigh the procompetitive effects. That agreement arises in part from an appreciation of the institutional limitations of the courts in making determinations about the ultimate benefits of innovation and efficiency enhancing behavior. It also derives from sensitivity to the innovation-reducing effects that such a legal intervention may bring.

Thus, U.S. jurisprudence affords wide latitude to monopolists to lower their own cost of production and to make their offerings more attractive to consumers. For example, the core meaning of exclusionary conduct is behavior that excludes competitors *on some basis other than efficiency*, to the detriment of consumers.[8] Conversely, conduct that excludes competitors on the basis of efficiency is not exclusionary in U.S. law, or it is judged exclusionary only in exceptional cases where the efficiency is small and the foreclosure of competition is great.[9]

Second, the Sections also respectfully suggest clarification of the section 5.5.3 discussion of concerted practices[10] to recognize greater leniency in enforcement policy

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[8] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605, 609 n.39 (1985).

*T*he Sections note that *Aspen* was decided on the facts before it in that particular proceeding. A later case, Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 409 (2004), characterizes *Aspen* as lying at the outer limits of liability for monopolization.

[9] In United States v. Microsoft Corp., 253 F.3d 34, 59 (D.C. Cir. 2001), the court said that "[i]f the monopolist asserts a procompetitive justification—a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal," "then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit." But there is little or no authority for conducting such a balancing test except where the efficiency gain is disproportionately small in relation to a major threat of injury to consumers. Many commentators argue that the courts are ill equipped to conduct such balancing. *E.g.*, III PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 658 & n.61 (2d ed. 2002).

[10] To establish the defense, a dominant firm must demonstrate that there are "no other economically practicable and less anticompetitive alternatives to achieve the claimed efficiencies …," ¶ 86; that the

for unilateral business decisions that may enhance efficiency and/or improve product characteristics, than for arrangements that temporarily or permanently reduce competition between independent business firms.[11]

Third, the more detailed discussion of the relation between productive efficiency and exclusionary abuse and the role of innovation would be welcome. Where innovation transforms a market, the less innovative firms may exit, thus reducing the competitive pressure that disciplines a dominant firm's ability to raise prices. In such a transformed market, the higher prices that purchasers pay may reflect not only improvement in product quality but, in addition, the market power derived from reduced competitive pressure. The latter component of the price increase may be defined as a "monopoly overcharge," and "consumer injury"—even while recognizing the offsetting benefit that arises from the availability of a better product.

We respectfully encourage the Commission to further clarify the phrase "competition on the merits" to negate any implication that innovative conduct that leads to improved products is not condemned as an exclusionary abuse. This, too, is a very difficult, but worthwhile task. Examples of such situations may be helpful to illustrate the point.

II. <u>COLLECTIVE DOMINANCE</u>

We respectfully urge that the Discussion Paper be clarified to ensure that the concept of abuse of collective dominance does not extend to purely interdependent behavior, i.e., conscious parallelism.[12] As currently drafted, it may be interpreted to

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benefits passed on to consumers outweigh the anticompetitive harm, ¶ 87; and that "competition in respect of a substantial part of the products concerned is not and will not be eliminated," because "[u]ltimately the protection of rivalry and the competitive process is given priority over possible pro-competitive efficiency gains." ¶ 91. There are several problems with the quoted language. First, consideration of efficiencies should not be limited to a "defense" but should fit within the overall assessment of whether any given conduct is, or has the potential to be, exclusionary. Second, as formulated the defense is unnecessarily restrictive and may be virtually impossible to establish. In addition, any efficiency defense (like other defenses) disappears where market share exceeds 75 percent and other indicia of monopoly are present. ¶ 92.

[11] Concerted practices and mergers are the exception, not the rule, whereas unilateral business strategy is omnipresent in the economy. Concerted practices and mergers are more easily evaluated for anticompetitive effect than is unilateral conduct. Where antitrust problems are found with concerted practices or mergers, they may simply be forbidden. By contrast, antitrust problems with unilateral business strategies are not easily remedied, and may require continual intervention by agencies and tribunals in individual business decision making. *See* VI PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1402 (2d ed. 2003).

[12] The Discussion Paper states that collective dominance may be established by an agreement or by interlocking ownership that leads to coordinated market activity, ¶ 45, but that "the existence of an agreement or of other links in law is not indispensable to a finding of a collective dominant position." ¶ 46. Citing the ECMR, the Discussion Paper says that "the structure of the market and the way in which undertakings interact on the market may give rise to a finding of collective dominance." *Id.* Paragraphs 47-50 go on to describe more fully the conditions that give rise to overt or tacit collusion. Paragraph 74, addressing "abuse of collective dominance," states that such abuse may occur where collectively dominant

imply that collective dominance may be found whenever firms successfully coordinate their decisions in the marketplace, even if (i) they are not under common control or common influence, by reason of ownership interests, interlocking management or other personnel, or other identifiable relationships, (ii) reach no agreement, and (iii) do not coordinate their activities by communicating with one another, but, instead, merely observe and/or take account of each others' individual and/or collective market behavior.

We submit that there is little analytical support in economics for enforcement actions based on shared monopoly,[13] especially actions alleging predatory pricing or refusal to supply. Accordingly, we urge the Commission to clarify that (i) collective dominance in an Article 82 context requires concerted action, (ii) coordinated interaction (without concerted action) is insufficient, and (iii) the abuse in question must have been the result of concerted action.[14]

The Sections further note that U.S. administrative proceedings concerning exclusionary practices in the breakfast cereal[15] and other industries that relied on a theory of shared monopoly were unproductive. The Federal Trade Commission found it difficult to manage complex proceedings involving theories of shared monopoly and the analytical basis of the proceedings was subject to considerable doubt.[16]

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firms "*tacitly* or expressly" follow "a common policy on the market, at least in regard to the abusive conduct." (emphasis added).

[13] *Id.* (citing Timothy J. Muris, Chairman, Fed. Trade Comm'n, "Looking Forward: The Federal Trade Commission and the Future Development of U.S. Competition Policy," Milton Handler Annual Antitrust Review (Dec. 10, 2002) at nn. 68 & 69, *available at* http://www.ftc.gov/speeches/muris/handler.htm); Charles A. James, Asst. Att. Gen., Antitrust Div., U.S. Dep't of Justice, "Antitrust in the Early 21st Century: Core Values and Convergence," Antitrust Policy in the 21st Century (May 15, 2002) at III.B.1.a, *available at* http://www.usdoj.gov/atr/public/speeches/11148.htm.

[14] If paragraph 98 is retained, we urge that it be revised to state that collectively dominant firms are very unlikely (not merely "less likely") to predate.

[15] In re Kellogg Co., 99 F.T.C. 8 (1982) (dismissing complaint).

[16] *See* William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 ANTITRUST L.J. 377, 451-52 (2003).

Similarly, the Canadian Guidelines note that the jurisprudence in respect of the criminal conspiracy provisions is clear in not condemning "conscious parallelism" and the Competition Bureau has adopted a similar position with respect to its abuse provisions, recognizing that something more that mere conscious parallelism must exist before the Bureau can reach a conclusion that firms are participating in some form of coordinated activity. Accordingly, to infer control by a group of firms, the Bureau will consider the following: (a) whether the group of firms collectively accounts for a large share of the relevant market; (b) whether there is coordinated behaviour and whether such behaviour is anticompetitive; (c) barriers to entry into the group, as well as barriers to entry into the relevant market; (d) whether actions have been taken by members of the group to inhibit intra-group rivalry; and (e) whether customers can exercise countervailing market power to offset the attempted abuse. *See* Competition Bureau, *Enforcement Guidelines on the Abuse of Dominance Provisions – Part 3: The Elements of Subsection 79(1)* (July 2001) *available at* http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1251&lg=e.

The Sections recommend that the Commission limit the concept of abuse of collective dominance to "situations where there [are] strong structural links between the undertakings holding the dominant position" – an approach that the Discussion Paper notes would be consistent with the existing case law. See paragraph 76 and situations where there is evidence of an actual agreement beyond conscious parallelism.

III. PREDATORY PRICING

The Sections agree with the Discussion Paper's position that overzealous enforcement against predatory pricing be avoided. ¶ 94. In particular, the Discussion Paper notes (i) the difficulties associated with distinguishing pro-competitive price cuts from predation—"The lowering of prices, the directly visible part of predation, is also an essential element of competition", ¶ 94—and (ii) that predatory pricing is certainly not widespread: "predation can be said to be to a certain extent self-deterring." ¶ 97.

The Average Avoidable Cost Test. The Discussion Paper discusses several cost standards. As a benchmark for suspiciously low pricing, the Discussion Paper adopts the average avoidable cost standard, ¶¶ 106-10, rather than the average variable cost standard articulated by the late Professor Areeda and adopted by many U.S. courts.[17] The Discussion Paper's average avoidable cost standard is certainly worthy of careful consideration.[18]

Other Cost-Related Issues. Two related questions are relevant: (1) over what time period must price be below the appropriate measure of cost to trigger suspicion of predation? and (2) what volume of sales is required to trigger intervention? On the first issue, the Discussion Paper states that, in most instances, the cost test should be applied for the period in which the allegedly predatory behavior takes place. However, the period in which a firm assesses the profitability of its commercial strategies may go beyond the period in which the supposed predation takes place. Therefore, some flexibility may be needed. For instance, an internet service provider may incur initial losses with new

[17] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993) (applying average variable cost standard, but declining to resolve conflict among circuits as to appropriate measure of cost); Spirit Airlines, Inc. v. Northwest Airlines, Inc., 431 F.3d 917 (6th Cir. 2005) (applying average variable cost standard); Taylor Publ'g Co. v. Jostens, Inc., 216 F.3d 465 (5th 2000) (same); Irwin Indus., Inc. v. Goodyear Aerospace Corp., 974 F.2d 241 (2d Cir. 1992) (same) (citing Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 716-18 & 733 (1975). *See* ALD, *supra* note 2, at 258-67.

[18] Clearly, a cost standard is crucial to determining that predation has occurred or is occurring. There should be a single cost standard that separates pricing policies that could be predatory from those that clearly are not. According to economic theory, this standard would best be a "proxy" for marginal cost. In most industries, the appropriate proxy would be average variable cost or average avoidable cost. In the telecommunications sector, the use of long run incremental cost has been recognized as appropriate for these purposes. The question about which of those cost criteria should prevail outside the limited circumstances in which long run incremental cost is appropriate is complex, although in principle, an economic case may be made that average avoidable cost is a better benchmark than average variable cost. *See* William J. Baumol, *Predation and the Logic of the Average Variable Cost Test*, 39 J. LAW & ECON. 49 (1996).; Brian A. Facey & Dany H. Assaf, *Monopolization and Abuse of Dominance in Canada, the United States and the European Union: A Survey*, 70 ANTITRUST L.J. 513, 552-55 (2002).

clients that may be compensated over the average "client life." On the second issue, the Sections welcome the Discussion Paper's observation in paragraph 59 that the "incidence" or market coverage is relevant to the assessment of foreclosure.[19]

Standard of Proof. The Discussion Paper raises two issues with regard to the required standard of proof for the elements of a predatory pricing abuse. First, depending on the cost standard, the Discussion Paper appears to shift the burden of proof for individual elements of a predatory pricing abuse from the Commission to the defendant. Neither the cost standards nor other presumptions set out in the Discussion Paper would appear to articulate a justification for varying standards of proof. The Sections believe that all elements of an abuse should be established in each individual case before finding a violation that would expose a company to significant fines and related private damage actions. Second, in the instances where the burden of proof for certain elements is shifted to the defendant, the required standard of proof appears almost impossible to meet. We respectfully suggest that the appropriate relevant standard of proof should be the same for the Commission as for the defendant.

The underlying reasons for shifting the burden of proof depending on the cost standard do not appear to be clearly articulated. To a certain extent, the Discussion Paper seems to assume that in these instances (*i.e., in every instance of* pricing below average avoidable cost and long run incremental costs, and sometime in other situations), a potential exclusionary effect and the possibility of recoupment are generally present and can therefore be presumed. *See, e.g.,* ¶ 109. However, *if* this assumption is correct, then the Commission should have no difficulty in establishing these elements in each individual case, and it is unnecessary to shift the burden of proof for these elements to the defendant. In addition, neither the potential exclusionary effect nor the likelihood of recoupment are elements for which evidence is particularly within the control of the defendant and thus are either impossible or even only significantly more difficult for the Commission to assess.

Pricing below Average Avoidable Cost. In cases involving pricing below average avoidable cost (or long run incremental costs, for certain sectors) pricing is presumed predatory without the need for the Commission to establish other elements. *See* ¶¶ 109, 125-26. The assignment of the burden of proof is less clear in the section on pricing above average avoidable cost and average total cost. While in principle it appears that the Discussion Paper suggests that the Commission should establish all the elements of a predatory pricing abuse in these situations, this section—even though to a lesser extent—also contains certain instances where elements are presumed. Paragraph 116, for instance, describes a relatively nebulous situation where showing a potential exclusionary effect is not deemed necessary.[20] Paragraph 122 seems to suggest that a likelihood of recoupment can (almost) always be presumed from a finding of dominance, and

[19] *See also* paragraph 117.

[20] Paragraph 126 states, "If the pricing only makes commercial sense as part of a predatory strategy and there are no other reasonable explanations, such will normally suffice to show a strategy to predate, certainly if other exclusionary practices are applied by the dominant company. In such cases it will not be necessary to show that a foreclosure is likely."

Paragraph 123 appears to recognize recoupment as a defense rather than a constituent element that needs to be proven to establish abuse. As further discussed below, the burden of showing objective likelihood of recoupment should always be on the Commission.

Generally, the Discussion Paper sets the standard for the Commission as requiring a *likelihood* of exclusion, *e.g.* ¶ 115, and a *likelihood* of recoupment. ¶ 122[21] Therefore, when the burden is shifted to the defendant, a defendant should prevail if it can show that, while such effects may be possible, there is no *likelihood* of exclusion or recoupment. Instead, the Discussion Paper asserts that defendants need to show that "*there is no possibility that [the pricing behavior] could have an exclusionary effect on rivals,*" ¶ 110, and that "*recoupment will never be possible.*" ¶ 123 (emphasis added). In addition to the fact that these standards are very difficult to meet, the Discussion Paper does not articulate a justification for imposing a higher standard on defendants than the Commission is required to meet. Read literally, these standards would seem to require a finding of anticompetitive exclusion where the rebuttal evidence shows that recoupment is highly unlikely but cannot be completely ruled out.

Pricing above average avoidable cost and below average total cost. Prices below average total cost but above average avoidable costs, as well as prices above long run incremental costs but below average total cost, will seldom meet the standard of predation laid out in paragraph 93. Prices covering variable costs and making some contribution to fixed costs would make perfect economic sense. Similarly, it may make economic sense to sell at prices covering variable but not fixed costs, for instance in the down side of the economic cycle, when demand is expected to change, in promotional phases, and so forth.

With respect to pricing at this level, the Discussion Paper, at paragraphs 111-12, places great emphasis on subjective intent. As discussed below, the Sections respectfully suggest that it would be better to emphasize objective economic analysis of conditions in the market, to assess whether paragraph 93's basic test of predation is met.

Pricing above average avoidable costs or average total cost. The Discussion Paper sets out certain situations in which prices above average total cost may be deemed to be predatory. ¶¶ 127-30.[22] This possibility may be difficult to square with economic theory. As a general matter, pricing above average avoidable cost or average variable cost should not be considered predatory, as it makes economic sense without regard to its impact on competitors and is incapable of excluding an equally efficient competitor.

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[21] The likelihood of recoupment is in fact assumed based on a finding of dominance. This raises issues in itself (see below, "Recoupment test").

[22] Where a dominant firm's pricing is above average avoidable cost but below total cost, the Discussion Paper, based on *AKZO*, Case C-62/86, AKZO Chemie BV v. Comm'n, 1991 E.C.R. I-3359, appears to place the burden on the Commission to prove predation, and provides an extensive discussion of direct and indirect evidence of a predatory strategy. ¶¶ 111-21.

The Discussion Paper mentions two examples. One is referred to as collective sharing of the loss of revenue, ¶ 128, which could easily be covered by Article 81 (coordinated behavior). The other is based on economies of scale. ¶ 129. If there is a natural monopoly, there may be justification for price regulation. If there is not a natural monopoly, a newcomer as efficient as the incumbent should not be shielded from competition, and average avoidable cost or average variable cost of the incumbent should be a reasonable benchmark for the entrant.

Predatory Intent. The Discussion Paper places heavy emphasis on evidence of predatory strategy. ¶¶ 115-124. It treats such evidence as relevant where the price is above variable or incremental cost, but below total average cost. Because there are so many situations considered to be evidence of intent, such as expansion of capacity reacting to entry, financial dependence of the prey and investment in reputation, the Commission may be able to prove predatory intent too easily, resulting in enforcement actions that may deter more aggressive competitive conduct which benefits consumers. Some of these may have a reasonable economic explanation and may be pro-competitive. For instance, additional investments of the incumbent when a newcomer has entered the market may not be anticompetitive, but may improve efficiency and benefit consumers. Evidence that a firm's pricing is in response to a rival's pricing may also, depending on the circumstances, negate an inference of a predatory strategy.

Recoupment Test. Recoupment is an essential part of the test for predation. The Discussion Paper acknowledges but downplays the role of one of the main elements identified in the economic literature on predatory prices: the possibility of recouping the losses incurred during the predatory period. Paragraph 122 appears to indicate that recoupment may be assumed when a dominant firm prices below the appropriate measure of cost in a market characterized by high barriers to entry. However, this may not be the case. If a dominant company prices below the applicable cost standard and one or more individual competitors eventually leaves the marketplace, it does not necessarily mean that the dominant company's prices harmed competition or consumer welfare. It depends on whether the exit(s) lead to an increase in the dominant firm's market power and whether the dominant firm is able to maintain or increase its prices for a sufficient period of time so that it can more than recoup its losses on a net present value basis. High barriers to entry at the time of the predatory pricing do not provide a basis for presuming that such recoupment would occur.

Defenses. Given the potential harm to competition of misinterpreting conduct as predatory, the Sections suggest that the Commission always evaluate the existence of alternative business rationales other than exclusion, not merely the issues discussed in paragraphs 130-134: minimizing losses, meeting competition and efficiencies.

The only objective justification expressly recognized in the Discussion Paper for allowing prices below average avoidable cost is when the dominant firm is minimizing losses in the short run, as could be the case when there is a need to sell off perishable inventory. There are many additional situations where it may make economic sense to sell below average avoidable cost. For instance, the introduction of new products or the introduction of new features in a given product may justify such a pricing policy for some period of time. This is particularly true in industries characterized by learning efficiencies, in which initial production batches are so costly that they cannot realistically be sold at a level that recovers even the incremental cost, but costs of the product diminish rapidly.

The delineated approach to the meeting competition argument does not allow the dominant firm to respond even with prices above average avoidable cost, unless several stringent conditions are met. In addition, not permitting a dominant company to invoke a meeting-competition defense to justify pricing below average avoidable cost, *see* ¶ 132, fails to consider that competitors may be more efficient than the dominant company.

Predation in "Adjacent Markets." We take note of the statement in paragraph 101 that "[p]redatory pricing by a dominant company in an unrelated market where it is not dominant and where the predation will only have effects in this unrelated market will normally not be an abuse." The circumstances under which a firm can successfully predate in a market where it does not possess market power would seem to be very narrow. In fact, it is difficult to envision how such a practice would be implemented. It would, therefore, be very helpful if the Commission explained more thoroughly what a "certain degree of economic interdependence" between two markets means.

IV. SINGLE BRANDING AND REBATES

The Sections appreciate the Commission's move away from the almost *per se* approach of recent cases such as *Michelin II* and *British Airways*[23] regarding the use of certain kinds of non-predatory rebates by a dominant firm. The Sections welcome the more careful and nuanced approach taken by the Discussion Paper toward rebates.

The Discussion Paper, however, still reflects a more negative view of single-branding obligations and non-predatory rebate systems than is warranted by those practices. In particular, single-branding obligations and certain rebate systems should not be presumptively illegal (even when undertaken by a dominant firm) but should be evaluated under either a rule of reason-type analysis or a predatory pricing analysis, depending on the exact conduct at issue. Under a proper rule of reason analysis, a number of factors should be considered, including the percentage of the market foreclosed, the duration of the single-branding arrangement, the level in the distribution chain at issue, the presence of alternative distribution channels enabling competitors to reach the market, entry conditions, use of the arrangements by competitors, and the extent to which competition is actually injured.[24]

Similarly, the Sections endorse clear and consistent illumination in the Discussion Paper that the intent is not to impose on the challenged party the burden of defending its practices, but instead that the burden will be on the challenger/complainant to prove that

[23] Case T-203/01 Manufacture Française des Pneumatiques Michelin v. Comm'n of European Communities, 2003 E.C.R. II-4071; Case 2000/74, Commission Decision of 14 July 1999 Relating to a Proceeding under Article 82 of the EC Treaty (IV/D-2/34.780-Virgin/British Airways).

[24] See ALD, *supra* note 2, at 221-25.

a particular practice actually injured competition. We respectfully suggest that such an approach would be beneficial given that single-firm conduct encompasses ubiquitous, everyday conduct, not the relatively unusual events at issue in concerted practices cases.[25]

A. Single Branding and English Clauses

Single Branding. The Sections supports the Discussion Paper's indication that the Commission will "take into account evidence for why . . . no distorting foreclosure effect may result," ¶ 149; for stating that "a short duration or right to terminate at short notice may make a market distorting foreclosure effect unlikely," *id.*; and for recognizing that in order for single branding provisions to be of concern, "a material volume of sales must be foreclosed." *Id.* The Sections also commend the Commission for recognizing the need to examine actual effects of conduct under consideration and, in particular, for recognizing that "[t]he longer the conduct has already been going on, the more weight will be given to actual effects," ¶ 155, and that entry and/or expansion by other firms is inconsistent with a theory of foreclosure. Par. 162(e).

The Sections respectfully suggest a more expansive and permissive view towards single branding. The Discussion Paper states, "Where the dominant company applies a single branding obligation to a good part of its buyers and this obligation therefore affects, if not most, at least a substantial part of market demand, the Commission is likely to conclude that the obligation has a market distorting foreclosure effect and thus constitutes an abuse of the dominant position." ¶ 149. This discussion appears to impose presumption of illegality based on the degree of foreclosure, which applies even where the buyers are only required to purchase "to a large extent" from one supplier." ¶ 135.

The Sections respectfully urges elimination of such a presumption. First, foreclosure is not the ultimate question; it is merely an intermediate one. Foreclosure is important only to the extent that it results in harm to competition—higher prices, lower quality, lower output, less choice.[26]

Second, single branding can have pro-competitive benefits, even when undertaken by a dominant firm.[27] The Discussion Paper recognizes the pro-competitive potential for single-branding obligations. *See* ¶ 138.

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[25] *See* AREEDA & HOVENKAMP, *supra* note 2, ¶ 1402 ("There are good reasons for regulating conspiracies more closely than the behavior of the single enterprise. The former are relatively infrequent, more easily appraised for reasonableness, and simply remedied through prohibition. By contrast, unilateral behavior is not only omnipresent; it is also difficult to evaluate or remedy by any means short of government management of the enterprise.").

[26] *See generally* Jonathan Jacobson, *Exclusive Dealing, 'Foreclosure' and Consumer Harm*, 70 ANTITRUST L.J. 311 (2003). For that reason, as Judge Posner made clear in one of his decisions, exclusive dealing should not be unlawful unless "the probable (not certain) effect of the exclusion will be to raise prices above (and therefore reduce output below) the competitive level or otherwise injure competition." Roland Mach. Co. v. Dresser Indus., 749 F.2d 380, 394 (7th Cir. 1984).

[27] *E.g.*, Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1162 (9th Cir. 1997) ("There are, however, well-recognized economic benefits to exclusive dealing arrangements, including the enhancement of interbrand competition."); Roland Mach. Co., 749 F.2d at 395 (noting that exclusive dealing arrangement

Third, single branding is a form of competition among firms, because sellers usually have to offer incentives to induce customers to accept a single branding obligation.[28] And the incentive typically lowers prices, benefiting customers.

Fourth, competitors are not necessarily passive players without means to respond to the dominant firm's actions. They often have the means to respond to an incentivizing offer for exclusivity by offering discounts to counter the dominant firm's offer.[29] Shielding the dominant firm's rivals from rebates would take away competitors' incentives to respond, resulting in higher prices.

For these reasons, the burden of proof should be on the party seeking to prove that the single-branding obligations injured the consumer. Notably, U.S. cases take a similar approach to that set forth in the Discussion Paper, placing importance on the degree of foreclosure. But under U.S. law, single branding (known as "exclusive dealing" in the U.S.) is analyzed under the rule of reason, with no presumptions based on degree of foreclosure.[30] For example, the FTC has written that "[a] proper analysis of [single branding] arrangements should take into account market definition, the amount of foreclosure in the relevant markets, the duration of the contracts, the extent to which entry is deterred, and the reasonable justifications, if any, for the exclusivity."[31] Indeed, in recent years exclusive dealing arrangements have been upheld by U.S. courts even when the defendants had market shares well in excess of what the EU would consider dominant.[32] A stricter approach is appropriate only where the single branding obligation was obtained by means of a refusal to deal, as the Discussion Paper recognizes in Par. 208. Where the single-branding obligation was obtained by means of incentives—i.e., fidelity or loyalty rebates—there is no articulated reason to depart from a rule of reason approach. The leading U.S. case on point focused on the actual effects of the practice, including the fact that customers "were free to walk away from the discounts at any time" as well as the fact that customers switched to the competitor's products "at various points

would increase competition in relevant market). *See* ALD, *supra* note 2, at 215 n. 1239 (collecting cases). Under U.S. law, market power is viewed as a necessary but not sufficient condition for a single-branding arrangement to be judged illegal. In other words, U.S. law generally employs a market-power screen to weed out non-meritorious cases; but the presence of market power is just the beginning of the analysis, not the end.

[28] *See* Paddock Publ'ns, Inc. v. Chicago Tribune Co., 103 F.3d 42, 45 (7th Cir. 1996) ("Competition-for-the-contract is a form of competition that antitrust laws protect rather than proscribe . . . ."); Commercial Data Servers, Inc. v. Int'l Bus. Machs. Corp., 262 F. Supp. 2d 50, 76 (S.D.N.Y. 2003) (same).

[29] *See* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209, 224 & n.59 (1986); Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, U. CHI. L. REV. 263 (1981).

[30] Willard K. Tom, et al., *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 ANTITRUST L.J. 615, 615-21 (2000) (describing the applicable rule of reason analysis).

[31] In re Beltone Elecs. Corp., 100 F.T.C. 68, 204 (1982) (footnotes omitted).

[32] *See Omega Envtl., Inc.*, 127 F.3d 1157 (55% market share); CDC Techs., Inc. v. IDEXX Lab., Inc., 186 F.3d 74 (2d Cir. 1999) (80% market share).

when that manufacturer offered superior discounts." [33] The leading Canadian case took much the same approach.[34]

The Commission should consider the important distinction between single-branding obligations imposed on customers through a refusal to deal with "disloyal" customers and one achieved through incentivizing behavior.[35] The former are likely to be of greater concern than the latter. This heightened concern is reflected in cases such as *United Brands*[36] in the EU and *Lorain Journal*[37] and *Dentsply*[38] in the U.S. When the obligation is imposed on the customer, the customer is given a take-it-or-leave-it choice; the dominant firm uses the power it has by virtue of controlling a must-stock item to force customers to stop dealing with competitors. It is appropriate to treat such conduct more strictly.[39]

On the other hand, many, if not most, single-branding relationships involve a consensual agreement between supplier and customer whereby the latter agrees to deal exclusively with the former and, as noted above, some form of incentive (such as a discount) is almost invariably involved. Indeed, such arrangements are often solicited by the customers themselves precisely to obtain some form of incentive. In other words, many single-branding arrangements are the result of a winner-take-all (or winner-take-most) competition instigated by the customer. Generally, customers put out such tenders only when they believe it will serve their interests.[40] A single-branding arrangement resulting from a customer tender should be presumptively legal. To overcome that presumption of legality, proof would be required that the customer was acting not in its own interests but in those of the supplier, somehow arranging to share in the latter's

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[33] Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039, 1059 (8th Cir. 2000).

[34] Canada (Comm'r of Competition) v. Canada Pipe, 2005 Comp. Trib. 3 (upholding system of rebates in exchange for customer exclusivity).

[35] *Compare Concord Boat*, 207 F.3d 1060-61 (market-share discounts upheld because the customers were not required but merely had a choice to accept the incentive) *and Canada Pipe*, 2005 Comp. Trib. at __ (upholding rebate program because it only created a financial incentive to exclusivity and competitors still "can offer, and have successfully offered, better bargains to sway buyers away from" respondent), *with* United States v. Dentsply Int'l, Inc., 399 F.3d 181 (3d Cir. 2005) (refusal to deal with disloyal dealers unlawful).

[36] Case 27/76 United Brands Co. & United Brands Continental BV v. Comm'n, 1978 E.C.R. 207.

[37] Lorain Journal Co. v. United States, 342 U.S. 143 (1951) (newspaper with monopoly over advertising in small town violated Section 2 of the Sherman Act by refusing to sell advertising space to local businesses also dealing with upstart radio station; violation of Sherman Act Section 2 violation affirmed).

[38] In *Dentsply*, the United States Court of Appeals for the Third Circuit held that a monopoly manufacturer of artificial teeth violated Section 2 with its policy of not selling to dealers that represented other artificial-tooth makers, thus preventing competitors from having access to a vital channel of distribution.

[39] *See* Andrew I. Gavil, *Exclusionary Distribution Strategies By Dominant Firms: Striking a Better Balance*, 72 ANTITRUST L. J. 3, 56-57 (2004) (illustrating this point with the Microsoft case).

[40] *See supra* note 28 for cases on point. *See also* Richard M. Steuer, *Customer-Instigated Exclusive Dealing*, 68 ANTITRUST L.J. 239, 240 (2000).

monopoly profits.[41] Competition generally will be enhanced if all firms are free to compete aggressively for such customer-driven opportunities. Deterring dominant firms from responding to such winner-take-all offers would reduce competition and, ultimately, harm consumers.

English Clauses. All of the above comments are likely to apply with even greater force to so-called English clauses, which require the buyer to give the seller an opportunity to match better offers from rivals. English clauses are less restrictive than single-branding obligations. The latter prohibit the buyer from dealing with other suppliers, at least for some period, for all or some portion of the buyer's purchases. English clauses, on the other hand, result in such exclusivity only if a certain condition is met—the supplier offers an equal or better price. That condition, obviously, is directly tied to the buyer's welfare.

B. Rebates

Conditional Rebates on All Purchases. While the Discussion Paper's treatment of conditional rebates moves away from the virtually *per se* approach to the cases, the Sections believe that the Discussion Paper's position on "conditional rebates on all purchases"— the main focus of its analysis of rebates—may still be read as being quite hostile to that type of practice.

A rebate always means a lower price to the customer or consumer, and that "cutting prices in order to increase business often is the very essence of competition [which] antitrust laws were designed to protect."[42] Even when the firm offering the rebates is dominant, the other firms in the market are still capable of responding with their own rebates (provided the dominant firm's rebates are not predatory). It would be undesirable to reduce the incentives of the dominant firm's rivals to compete by shielding them from vigorous price competition. Every rebate system may be viewed as having a "suction effect," so rebate schemes should not be condemned based on that concept alone.[43] The analysis set forth in the Discussion Paper could be interpreted as condemning such pro-competitive conduct.

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[41] *See* Steuer, *supra* note 41, at 251 ("Courts should hesitate to substitute their own judgment for that of a customer where the customer is trying to sharpen competition among potential suppliers and strike the best deal it can.").

[42] Matsuhsita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986). While economics would predict that lower prices to wholesale or retail customers generally are passed along to consumers absent a lack of competition at that intermediate downstream level, lower prices to those intermediate customers are in themselves procompetitive whether or not the lower price makes it to the consumer. *See, e.g.,* FTC v. H.J. Heinz Co., 246 F.3d 708, 719 (D.C. Cir. 2001) ("no court has ever held that the reduction in competition for wholesale purchases is not relevant unless the plaintiff can prove impact at the consumer level.").

[43] *Cf.* Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 767-68 (1984) ("[I]t is sometimes difficult to distinguish robust competition from conduct with long-run anticompetitive effects."); Daniel L. Rubinfeld, *3M's Bundled Rebates: An Economic Perspective*, 72 U. CHI. L. REV. 243 (2005) ("[B]ecause procompetitive conduct . . . can weaken rivals, weakening rivals is not by any means sufficient to condemn a monopolist's conduct.").

The Sections respectfully suggest that the Commission adopt a simpler test, such as an "attribution" approach under which the rebates on the "uncontestable" portion of the sales are attributed to the "contestable" portion (the idea being that the claim that those rebates are being paid on the uncontestable portion is pre-textual).[44] This is essentially what is illustrated in the box following Paragraph 154. A simple attribution approach could capture truly anticompetitive conduct without ensnaring pro-competitive conduct.

None of this is to suggest that true incontestability is common. Therefore, incontestability should not be lightly found. Moreover, the box following Paragraph 154 seems to assume a static situation. But if the customer were to increase its requirements during the time period by even a small amount —and economic theory predicts that the customer would increase purchases in response to lower prices—the ability of a challenger to match the dominant firm's discounts and recover its costs would likely increase. This illustrates that many of the Discussion Paper's assumptions underlying this supposedly mathematical analysis may be oversimplified for many business situations. The Sections commend the Discussion Paper for recognizing that the entrant's shares may differ from customer to customer, but are concerned that that recognition may not be fully reflected in the analysis.[45]

The Sections are also concerned with the suggestion in paragraph 165 that even an effective price above average total cost could in some circumstances be deemed abusive. There is also no clear justification why a different cost approach should be used

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[44] *See* Willard K. Tom, et al., *supra* note 31, at 628-29. In this context, the term "contestable" refers to the universe of products to which the predatory pricing test should be applied. Exactly how that universe is determined may not always be obvious, but as the Areeda/Hovenkamp treatise explains: "The relevant line in which to make price-cost comparisons depends on the nature and purpose of the predation and on the mechanism by which competition might be impaired." I AREEDA & HOVENKAMP, *supra* note 2, ¶ 742c1.

[45] Paragraph 157 states that "The Commission will establish the effect on an entrant that would enter at minimum efficient scale and which would sell the same percentage to each customer in the market." The Commission's methodology asks whether the challenger can recover its cost if it matches the discount and obtains only its marketwide share at the customer for which the fidelity rebate has been offered. Unfortunately, this distorts the outcome, as can be shown by the following example. Take a 10% discount on an 90% market share, where the normal price is €10 and both firms' cost is €6. Assume that the customer buys a total of 100 units. That means that buying 80 units from the dominant firm costs €800, buying 90 units costs €810, and buying 100 costs €900. Assume that the challenger's overall market share is 20% but that its share at various customers ranges from 0 to 50%. If the challenger is assumed to be able to get only 20%, its overall share, it has to sell 20 units for $100 to match the offer (i.e., the customer would pay €900 for buying 100 units from the dominant firm, but €800 for 80 units, leaving the rival to collect only €100 for the last 20 units). This results in a price of €5, which is below cost. But if the rival can go for 40%, for example, which is within the range of shares that it has achieved at various customers, it can now charge $300 for 40 units, or $7.5 per unit, which is above cost. To the extent that it rules out the challenger's ability to achieve the share that it has demonstrably obtained, the Discussion Paper as drafted inappropriately tilts the predation scale and renders illegal efficient conduct which benefits consumers. We note, however, that paragraph 157 also acknowledges that entrants may achieve a higher share than their average share if they "concentrate sales on a limited number of customers to whom they can sell more per customer," and that this may affect the analysis. Given this acknowledgment, it would be preferable to eliminate the "same percentage" presumption altogether.

in connection with rebates than in connection with the predatory pricing. Yet that seems to be suggested.

Finally, the Discussion Paper places the burden of proof on the challenged party rather than on the challenger. *See, e.g.*, ¶ 165 ("the dominant company may rebut the Commission's preliminary conclusion …"). The Sections believe that this should be reversed. The Discussion Paper recognizes that tying and bundling are "common practices that often have no anticompetitive consequences"; the Discussion Paper should similarly make this point about rebates.

Other Types of Rebates. The Sections commend the Discussion Paper position that a "rebate only on incremental purchases" will be considered abusive "only if the resulting price for these incremental purchases is a predatory price." ¶ 168. However, the Sections believe that the use of average total cost as the measure of cost for evaluating predation is inappropriate: where a discount is applicable only to incremental sales, an incremental cost measure is appropriate, since any recovery of incremental cost is profitable without regard to the impact of the rebate on competitors.

The Section also commends the Discussion Paper position that rebates in return for the supply of a service by the buyer are normally not abusive. ¶ 170.

C. Selective Single Branding or Rebates

The Discussion Paper states, "The Commission will also investigate whether the single branding obligation or rebate system is targeted at the customers of specific competitors. In such cases the Commission may find that a market distorting foreclosure effect results even though the tied market share is very modest." ¶ 145.

In theory, this may be true in certain limited circumstances. But the Sections believe that such a finding should not be made often as there is a serious risk that enforcement action in so-called targeting cases will restrain pro-competitive behavior and negatively impact consumers.[46] More fundamentally, selective targeting should be dealt with under the predatory pricing rules, especially with respect to rebates. Above-cost discounts directed at the most elastic customers should not be deemed predatory.

D. Possible Defenses

The Section commends the Commission for expressly acknowledging that the dominant company can defend its conduct based on efficiency considerations (subject to the earlier comment that efficiencies should be part of an initial rule of reason-type analysis rather than being relevant only at a "defense" stage). The Section also commends the Discussion Paper for making clear that the examples it cites are only that—examples—and that it is possible for other efficiencies to be demonstrated.

[46] *Cf.* Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc., 126 S. Ct. 860, 865 (2006) ("selective price discounting [can] foster[] competition among suppliers of different brands").

The Discussion Paper could be expanded to add certain other efficiencies to the list of examples. For example, in the right circumstances dealer focus can create an efficiency that enhances interbrand competition. As Judge Posner explained: "A dealer who expresses his willingness to carry only one manufacturer's brand of particular product indicates his commitment to pushing that brand; he doesn't have divided loyalties. If the dealer carries several brands, his stake in the success of each is reduced."[47] Single branding can also be critical in preventing dealers from passing off inferior products.[48]

As to the third example given in the Discussion Paper—relationship-specific investments—the Sections believe permissible conduct could be expanded to reflect that a supplier may have a legitimate investment-related reason for imposing a single-branding requirement on a customer even where the investment is not "relationship-specific."[49]

Of course, the challenged party's rebate practices can and should be taken into account in the initial determination of whether it has dominance. As the Discussion Paper notes, "the fact that an undertaking [that] is compelled by the pressure of its competitors' price reductions to lower its own prices . . . is incompatible with the existence of substantial market power." ¶ 27.

E. Meeting Competition

The Discussion Paper states that, in general, meeting competition cannot be used to defend single-branding obligations. The Sections note, however, that denying the meeting competition defense in these circumstances may provide a competitive advantage to the dominant firm's rivals but provides no benefit to consumers and may therefore have certain adverse and unintended consequences on competition. Defenses, and particularly meeting competition defenses, should always be analyzed on a case-by-case basis given their ability to increase competition.[50] The Sections urge the

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[47] *Roland Mach. Co.*, 749 F.2d at 395 (citing Sulmeyer v. Coca-Cola Co., 515 F.2d 835, 840 n.2 (5th Cir. 1975)).

[48] *E.g.*, F.T.C. v. Sinclair Refining Co., 261 U.S. 463, 475-76 (1923).

[49] *See* Howard P. Marvel, *Exclusive Dealing*, 25 J.L. & ECON. 1 (1982). *See also Roland Machinery*, 749 F.2d at 395 ("Exclusive dealing may also enable a manufacturer to prevent dealers from taking a free ride on his efforts (for example, efforts in the form of national advertising) to promote his brand. The dealer who carried competing brands as well might switch customers to a lower-priced substitute on which he got a higher margin, thus defeating the manufacturer's effort to recover the costs of his promotional expenditures by charging the dealer a higher price."); Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1235 n.17 (8th Cir. 1987) (exclusive dealing "encourages the manufacturer's investment in marketing activity, and thus encourages interbrand competition"); Beltone Elecs. Corp., 100 F.T.C. at 186, 192 & 209 (recognizing that exclusive dealing prevented dealers from free riding on manufacturer's efforts to locate potential customers of hearing aids).

[50] *See* United States v. AMR Corp., 140 F. Supp. 2d 1141 (D. Kan. 2001), *aff'd*, 335 F.3d 1109 (10th Cir. 2003)

Commission to acknowledge expressly that meeting competition is allowable with respect to rebates, for the reasons set forth above in the predatory pricing section.[51]

V. TYING AND BUNDLING

The approach to tying and bundling set out in the Discussion Paper is very positive. In particular, the Sections commend the Discussion Paper for recognizing that tying and bundling "are common practices that often have no anticompetitive consequences" and that companies "may also engage in tying for reasons related to the quality, reputation and good usage of their machines." ¶ 178. The Sections also endorse recognition, in paragraph 187, that the technical integration of two products may constitute a new product, rather than a tie or bundle.

As to the definition of the issue in paragraph 182, however, the Sections respectfully suggest that there is an important difference between "forcing" customers to buy the tied product or a bundle, and "inducing" them to do so. Forcing leaves the customer with no effective choice, whereas inducing does. Forcing is also a direct use (or, more accurately, misuse) of the dominant firm's market power; inducing, by contrast, is a form of competition whereby the dominant firm merely uses its financial resources, as to which it is not dominant. Where there is an inducement to accept a bundle of products — meaning a financial incentive but one that leaves the customer with a meaningful choice — the conduct may more appropriately be tested under a predatory pricing framework, considering whether the individual product's net prices meet the test for predatory pricing. Such treatment would mean that the incentives at issue would not be condemned unless they met all elements of a predatory pricing offense, including the requirement that the investment in below-cost pricing be subject to recoupment.

A pricing scheme may in some circumstances constitute a tie. One example is where the stand alone price for the "tying" product increases when it is bundled with the "tied" product, *i.e.*, consumers are being charged for the "tied" product whether or not they buy it. In that case, the "tying" product can be treated as effectively unavailable on a stand alone basis. But if the tying product is still available at the same price prior to the

[51] The Sections further note that other aspects of the Discussion Paper's discussion relating to meeting competition raise concerns which should be clarified in line with proper economic analysis, in part to assure some greater predictability to business decision-making. For example, paragraph 82 states that any discounting must meet a proportionality test which requires a company to weigh its desire to minimize losses with the interests of competitors to enter or expand, a process which could well deter above-cost reactive pricing strategies which benefit consumers directly and by stimulating rounds of price cuts. In addition, paragraph 82's general statement that the meeting competition defense is not available if "the conduct also involves extra investments in capacity and is therewith not minimising losses directly resulting from the action take by certain competitors" should be clarified so as not to undercut the fundamental recognition in paragraph 175 that "[g]eneral or market-specific investments in (extra) capacity are normally not relationship-specific investments" and can be efficiency-enhancing . Since paragraph 27 recognizes that pressure from competitors' pricing that leads a company to lower its own prices "is in general incompatible with the independent conduct which is the hallmark of a dominant position," a company that lowers its prices should not face so circumscribed a meeting competition defense. *See* United States v. Aluminum Co. of Am., 148 F.2d 416, 430 (2d Cir. 1945) ("The successful competitor, having been urged to compete, must not be turned upon when he wins.").

creation of an inducement to buy both products together, then merely because the bundle is more financially attractive than the sum of the separate parts does not mean that it involves a coercive "tie" that should be subject to harsh treatment. The ability of rivals to offer their own bundles should be considered as part of the analysis.

The Sections respectfully suggest a test congruent with the predatory pricing analysis described above in connection with contestable and uncontestable portions of the dominant firm's sales, rather than the incremental cost approach specified on the Discussion Paper. Under such an approach, a determination would be made as to whether the discount on Product A in fact induces customers to purchase Product B. If so, then those rebates should be attributed to Product B for a determination as to whether Product B is being sold at predatorily low levels.

Finally, the Sections commend the Discussion Paper's clarity that the absence of objective justification or efficiencies is one of the elements necessary to establish an abuse. ¶ 183. However, paragraph 206 appears to shift the burden to the respondent to prove objective justifications or efficiencies, which could defeat the objective point of making their absence an affirmative element. That burden should rest with the challenger of the conduct.

Given that the analysis of foreclosure effects in individual cases will inevitably be highly fact specific, the Commission may wish to further describe the degree of foreclosure that will give rise to concern (*e.g.*, "good part", "significant part", "substantial part," etc.). Use of a single consistent term to describe the level of foreclosure that will give rise to concern (*e.g.*, "substantial part" of the market), and provide guidance on what level will normally not give rise to concern in the absence of special circumstances would be beneficial. The Sections note, in this regard, that paragraph 198 indicates that if "only one-third" of the customers in a tied market buy both the tying and the tied products, tying may pose less of a risk. We urge the Commission to provide further concrete guidance as to "safe harbors" in other contexts. Such "safe harbors" would be especially helpful to businesses trying to evaluate the legality of proposed courses of action in advance.

VI. REFUSALS TO SUPPLY

A. Overview

In Section 9, the Discussion Paper addresses the difficult issues associated with identifying the circumstances under which a dominant undertaking's refusal to supply can be anticompetitive. The section is divided into three primary parts: (1) termination of an existing supply relationship; (2) refusal to start supplying an input, including refusal to license intellectual property rights; and (3) refusal to supply information needed for interoperability. Constructive termination and constructive refusal to supply are also addressed. A different standard is provided for each. Nevertheless, a common and laudable identified theme is that a refusal to supply "must … have a likely anticompetitive effect on the market which is detrimental to consumer welfare" before it will be considered abusive. ¶ 210.

Right to Determine Whom to Supply. Under EU competition law, as well as U.S. law, undertakings, including dominant undertakings, "are generally entitled to determine whom to supply and to decide not to continue to supply certain trading partners." ¶ 207. A firm may refuse to supply because of the cost of supplying a customer, when the customer has poor credit, orders are infrequent or irregular, or the customer is located a great distance from the supplier's warehouses. Other legitimate business considerations may make a seller reluctant to deal with a buyer, as when the supplier offers a high quality differentiated product and the customer is a discount retailer. The Sections urge that exceptions to the general rule that undertakings have the right to determine supply relationships be clear, very limited, well defined, transparent to the business community, designed to reduce business uncertainty, and imposed with great caution.[52]

Uncertain State of the Law. This area of the law has been subject to considerable controversy in the United States and the European Union, particularly with respect to the compulsory licensing of intellectual property rights, including copyrights, patents, and trade secrets.[53] The business and legal communities would be greatly

[52] In *Trinko*, the U.S. Supreme Court observed that, although "[u]nder certain circumstances, a refusal to cooperate with rivals can constitute anticompetitive conduct and violate [Section 2 of the Sherman Act]," such circumstances are limited exceptions to the "long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal." 540 U.S. at 408 (second alteration in original) (citing United States v. Colgate & Co., 250 U.S. 300, 307 (1919)). The Court noted that it has been "[v]ery cautious in recognizing such exceptions, because of the uncertain virtue of forced sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm." *Id.*

[53] *See* Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 ANTITRUST L.J. 841 (1989); Onno W. Brouwer, *An Improved Framework for Refusal to Supply Cases*, presented at the Second Conference of the Global Law Competition Centre, Bruges, Belgium (June 16-17, 2005) *available at* http://www.coleurop.be/file/content/gclc/documents/GCLC%20refusal%20to%deal.doc; Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 311 (2003); Frank Fine, *European Community Compulsory Licensing Policy: Heresy versus Common Sense*, 24 NW. J. INT'L L. & BUS. 619 (2004); Frank Fine, *NDC/IMS: In Response to Professor Korah*, 70 ANTITRUST L.J. 247 (2002); Frank Fine, *NDC/IMS: A Logical Application of Essential Facilities Doctrine*, 23 EUR. COMPETITION L. REV. 457 (2002); Eleanor M. Fox, *Is There Life in Aspen after Trinko? The Silent Revolution of Section 2 of the Sherman Act*, 73 ANTITRUST L.J. 153 (2005); Kenneth L. Glazer and Abbott B. Lipsky, Jr., *Unilateral Refusals to Deal Under Section 2 of the Sherman Act*, 63 ANTITRUST L.J. 749 (1995); Donna M. Gitter, *Strong Medicine For Competition Ills: The Judgment of the European Court of Justice in the IMS Health Action and Its Implications for Microsoft Corporation*, 15 DUKE J. COMP. & INT'L L. 153 (2004); Christophe Humpe & Cyril Ritter, *Refusal to Dea*l, (July 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id-771907; Valentine Korah, *The Interface Between Intellectual Property and Antitrust: The European Experience*, 69 ANTITRUST L.J. 801 (2002); Marina Lao, *Aspen Skiing and Trinko: Antitrust Intent and "Sacrifice*," 73 ANTITRUST L.J. 171 (2005); Abbot B. Lipsky, Jr. & J. Gregory Sidak, *Essential Facilities*, 51 STAN. L. REV. 1187 (1999); John E. Lopatka & William H. Page, *Bargaining and Monopolization: In Search of the "Boundary of Section 2 Liability" Between Aspen and Trinko*, 73 ANTITRUST L.J. 115 (2005); Paul D. Marquardt and Mark Leddy, *The Essential Facilities Doctrine And Intellectual Property Rights: A Response to Pitofsky, Patterson, and Hooks*, 70 ANTITRUST L.J. 847 (2003); Alan J. Meese, *Property, Aspen, and Refusals to Deal*, 73 ANTITRUST L.J. 81 (2005); Robert Pitofsky, et al., *The Essential Facilities Doctrine under U.S. Antitrust Law*, 70 ANTITRUST L.J. 443 (2002).

assisted by clearly articulated guidelines regarding to how the Commission will assess refusals to supply.

Impact of Imposition of an Obligation to Supply. The Discussion Paper notes that that the imposition of an obligation to supply may adversely impact a dominant company's investment decisions. Likewise, it recognizes that some companies "may be tempted to free ride on the investment made by the dominant company instead of investing themselves." ¶ 213. The Discussion Paper also states that "[e]nforcement policy towards refusals to supply has to take into account both the effect of having more short-run competition and the possible long-run effects on investment incentives." ¶ 213.

Additional clarity on how such differing effects will be assessed, particularly given the inherent limitations in predicting such effects and balancing short-term effects against long-term considerations, would be of benefit to the business community. Certain presumptions that appear to underlie the Discussion Paper's analysis emphasize short-term effects on competition and to downplay the long-term adverse effects on innovation that may arise from overly strict enforcement. It would be helpful if the discussion could expand on and emphasize more on the procompetitive benefits of preserving incentives for certain types of investments, particularly incentives to engage in costly research and development, which are important sources of innovation. By expanding the discussion a balance can be achieved between the protection of competition and the protection of the right to reap a reasonable return on investments in research and development.

Proposed Standards for Abusive Conduct. The Discussion Paper delineates separate prerequisites for conduct to be characterized as abusive. For the termination of an existing supply relationship to be found abusive, four conditions must be satisfied: "(i) the behaviour can be properly characterized as termination; (ii) the refusing undertaking is dominant; (iii) the refusal is likely to have a negative effect on competition; and (iv) the refusal is not justified objectively or by efficiencies." ¶ 218. For a refusal to start supplying an input to be abusive, five conditions must be satisfied: "(i) the behaviour can be properly characterized as a refusal to supply; (ii) the refusing undertaking is dominant; (iii) the input is indispensable; (iv) the refusal is likely to have a negative effect on competition; (v) the refusal is not objectively justified." Section 9.2.2. An additional condition is required with respect to licensing of intellectual property rights: the undertaking requesting the license must intend "to produce new goods or services not offered by the owner of the right and for which there is a potential consumer demand" and not merely duplicate "the goods or services already offered on this market by the owner of the IPR." ¶ 239. At paragraphs 241-42, the Discussion Paper reasons that since "leveraging market power from one market to another by refusing interoperability information may be an abuse of a dominant position," even if interoperability information "may be considered a trade secret it may not be appropriate to apply to such refusals to supply information the same high standards for intervention."

In general, these proposed standards provide a useful starting point, especially as to the evaluation of situations where the refusal to supply is best viewed as an instrument to achieve another purpose. Where the refusal to supply is best understood as an instrument to achieve another purpose, such as single branding or tying, the conduct would properly be characterized as a single branding or tying practice and would be analyzed under the standards applicable to such practice. ¶ 208. This approach is sound because it focuses on the fundamental underlying behavior and ensures consistency in the implementation of competition policy.[54]

While the standards noted above are an improvement over existing EU case law, they nevertheless could still potentially chill legitimate competitive conduct. Respectfully, there is no sound economic basis for setting a lower hurdle for a finding of abuse in the case of termination of an existing relationship than for an initial refusal to supply.

B. Termination of an Existing Relationship

Proposed Rebuttable Presumption and Burdens of Proof. The Discussion Paper considers the imposition of a rebuttable presumption that continuing existing supply relationships is procompetitive, reasoning that the dominant company had previously considered it efficient to engage in such supply relationships, and its customers are likely to have made investments connected to these supply relationships. ¶ 217. Furthermore, on the discussion of downstream integration by a dominant firm (and accompanying refusal to supply downstream competitors) the paper mandates an affirmative showing that "consumers are better off with the supply relationship terminated." ¶ 224. The Sections suggest that such evidence should be a factor in the analysis but not a presumption. Presumptions could deter procompetitive conduct to the extent they implicitly assume that the conduct in question is anticompetitive unless proven otherwise. A dominant firm's decision to change its supply relationships may be an effort to find greater efficiency in recognition of changed circumstances or opportunities. Adopting a rebuttable presumption and imposing a high standard of proof for overcoming it could artificially serve to protect existing relationships and downstream firms from the need to become more competitive and efficient.

Given the dynamic nature of modern economies, the fact that a supply relationship may have been previously profitable for the dominant firm does not by itself mean that the relationship was profitable at the time of termination. Responsibility for the other party's investment in the supply relationship could be determined by reference to the rights and obligations of the parties under the contract and should not serve to provide an independent basis for an obligation to supply. Moreover, it is not clear why the proposed standards on abusive conduct should require proof that an input is indispensable in a refusal to start supplying an input context, while they do not require such proof in the context of termination of an existing relationship. A dominant undertaking operating in a legal environment where termination of an existing supply relationship would subject it to greater risk of antitrust liability than declining to enter in to a supply relationship, could thereby have less incentive to enter into a new supply

[54] Under *Trinko* a refusal to supply, without more, is seldom, if ever, an unlawful act of monopolization. *See* 540 U.S. at 407-08.

relationship in the first place.[55] Such a legal environment could have a chilling effect on dominant firms considering whether to begin supplying an input and could result in a sub-optimal distribution of goods or services. To avoid such an unintended consequence, we recommend the following in connection with the termination of an existing relationship: the presumption that continuing the existing relationship is procompetitive be eliminated, although it certainly is a relevant factor in the analysis; the burden of showing that consumers would be better off with the supply relationship terminated should be removed; and proof that the input is indispensable be required.

Constructive Termination. The Discussion Paper identifies a number of ways in which a dominant firm might constructively terminate a supply agreement (or refuse to supply). These include delay, imposing unfair trading conditions, charging excessive prices for an input, or charging prices for an input that are too high to allow the buyer to compete downstream with the dominant firm ("margin squeeze"). ¶¶ 219-20. The Discussion Paper does not define the circumstances under which delay, "unfair" trading conditions or "excessive" prices would constitute abuses, and there has been no clear guidance from the European Court of Justice. The Discussion Paper's proposed approach raises a substantial risk that competition law could be used to promote price regulation at the behest of customers that seek to use antitrust complaints as a tool for obtaining better prices. The discussion of constructive termination risks could therefore uncertainty and deter legitimate competitive behavior. Accordingly, it is suggested that either greater guidance be given or that explicit treatment of constructive termination be eliminated.

Margin Squeezes. Margin squeezes are defined in the Discussion Paper as situations in which a vertically integrated company supplies a downstream competitor with an upstream input at a price that "is insufficient to allow a reasonably efficient competitor to obtain a normal profit." The Discussion Paper suggests that a margin squeeze "could . . . be demonstrated by showing that the input owner's own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by its upstream operating arm." ¶ 220.

Conceptually, margin squeeze cases are more akin to predatory pricing than refusals to deal.[56] As with predatory pricing, the Sections believe that enforcement aimed at guaranteeing competitors a "normal profit" is likely to result in over deterrence and loss of consumer welfare.

[55] *See* Phillip Areeda, *supra* note 54, at 850 ("[O]ne of the consequences will be that lawyers will advise their clients not to cooperate with a rival; once you start, the Sherman Act may be read as an antidivorce statute."). *See also* Glazer & Lipsky, *supra* note 54, at 800 ("If the plaintiff's true grievance is that the defendant pulled the rug out from under him, he should sue under contract law or rely on other legal mechanisms designed for the purpose.") and Einer Elhauge, *supra* note 54, at 314 ("Indeed, such a limitation would create a perverse incentives for a monopolist to refrain from ever dealing with a rival, even if otherwise inclined to do so, out of fear that this proposed antitrust rule would convert any such dealing into the sort of lifetime tenure normally reserved for professors.").

[56] Indeed, the Commission brought the *Wanadoo* case as a predatory pricing case rather than a price-squeeze case *See* Case COMP/38.233, Comm'n Decision of 16 July 2003 Relating to a Proceeding under Article 82 of the EC Treaty (Wanadoo Interactive).

Likely Negative Effect on Competition. The Discussion Paper does not provide a precise definition of what constitutes a likely negative effect on competition within the context of a termination of an existing supply relationship. It is only clear that a likely negative effect on competition may be found even if competition in the downstream market has not been completely eliminated. ¶ 222. Although the Discussion Paper notes that the termination of one individual customer does not in itself constitute an abuse, it also notes that the "the termination of one customer may have a detrimental effect on the level of competition." ¶ 222. In the event that an input supplier is itself active in the downstream market and terminates supplies to one of its few competitors, a negative effect on competition on the downstream market will be presumed. The Sections submit that such a presumption could chill competitive conduct, including discouraging dominant firms from voluntarily supplying rivals.

C. Refusal to Start Supplying an Input

The test specified in the Discussion Paper for imposing an obligation to supply is similar to the essential facilities doctrine.[57] There is disagreement among competition law regimes and prominent antitrust commentators on whether the essential facilities doctrine is consistent with proper competition law goals, and, if it is, how such a doctrine should be formulated. Some U.S. antitrust practitioners and commentators maintain that the essential facilities doctrine has little or no utility.[58] Scholars have criticized the doctrine on a variety of grounds, including (i) mandatory sharing obligations may deter investment and innovation; (ii) the doctrine's unfettered application to intellectual property could penalize successful innovators; (iii) the doctrine puts courts into the ill-suited role of public utility regulators; (iv) the doctrine provides unsuccessful competitors with an inappropriate tool for free-riding on the success of rivals; and (v) the doctrine requires regulated terms of access which are unlikely to result in efficient pricing. Others believe the principle may usefully be applied in "those rare and exceptional circumstances where a facility is truly essential to competition . . . the anticompetitive

[57] Those United States Circuit Courts of Appeal that have recognized the essential facilities doctrine have applied it very narrowly, and have sought to tailor specific criteria that must be proven before access may be compelled. These criteria include: (i) proof of actual harm to competition from the refusal to deal, which is a fundamental element of any monopolization claim; (ii) control of the essential facility by a monopolist; (iii) a competitor's inability practically or reasonably to duplicate the essential facility; (iv) the denial of the use of the facility to a competitor; and (v) the feasibility of providing the facility to competitors. *See* ALD, *supra* note 2, at 278-86.

[58] A leading U.S. treatise takes this view. *See* AREEDA & HOVENKAMP, *supra* note 2, ¶ 771c ("[T]he essential facility doctrine is both harmful and unnecessary and should be abandoned"). *See also* Paul D. Marquardt & Mark Leddy, *The Essential Facilities Doctrine And Intellectual Property Rights: A Response To Pitofsky, Patterson and Hooks*, 70 ANTITRUST L.J. 847 (2003). The U.S. Supreme Court's decision in *Trinko* discussed the risks to competition posed by any broad application of the essential facilities doctrine. The decision cast doubt on the continuing viability of the essential facilities doctrine under the Sherman Act by indicating that prior Supreme Court cases "never recognized such a doctrine." However, at the same time, the Court found "no need to either recognize or repudiate" the doctrine, opining instead that essential facilities claims should be denied "where a state or federal agency has effective power to compel sharing and to regulate its scope and terms." 504 U.S. at 411.

effects of denial of access are severe, and there is no business justification" for the owner's denying access.[59]

While undertakings do not enjoy an unqualified right to refuse to sell goods or services, or otherwise to cooperate, the legality of all such unilateral refusals to deal should—like other purportedly abusive business practices—be examined by considering whether the conduct is likely to: (i) aid an undertaking to acquire, maintain, or extend market power; (ii) fail to promote competition on the merits of price, quality, and service; (iii) lack an efficiency justification; and (iv) serve mainly to prevent competition from others.

To be consistent with this approach, the essential facilities doctrine would not be applied to find a duty to deal, in the name of fairness to smaller competitors or potential competitors, unless the refusal aids the dominant firm to acquire, maintain, or extend its dominant position by excluding a competitor. A broader imposition of a duty to deal could harm consumers by depriving them of the benefits of price or non-price competition from which they otherwise would benefit. Furthermore, the analysis could also consider the dominant firm's objective justifications for refusing to supply, such as the need to incur significant effort or costs to make supplying the rival possible.

Hypothetical Secondary Market. In defining the secondary market, the Discussion Paper provides that identification of "a potential market, or even a hypothetical market" would be sufficient. ¶ 227. The Sections do not believe that an obligation to supply should be imposed without a clear identification of relevant markets at both the upstream and downstream levels. If an obligation to supply in a market that does not exist is to be imposed at all, the final guidelines could make clearer how such a hypothetical market will be identified and defined.

Indispensability. The Discussion Paper recognizes that in order for a refusal to start supplying an input to constitute an abuse, the input must be indispensable for carrying on normal economic activity in the downstream market and that no real or potential substitutes exist in the market. ¶ 228. To the extent that the Paper ultimately seeks to exclude or limit the application of an obligation to supply to intellectual property rights (see discussion *infra*), then paragraph 230, concerning intellectual property rights, should be deleted or revised.

Likely Negative Effect on Competition. The Discussion Paper does not define what constitutes a likely negative effect on competition with respect to the refusal to start supplying an input. It is only clear that a likely negative effect on competition will require less than the elimination of all competition from the downstream market. ¶ 231. Although the Discussion Paper notes that exclusion of one individual competitor does not in itself constitute an abuse, it also asserts that the "extent to which the exclusion of one competitor has an impact on the level of competition depends on the pre-existing competition on the downstream market." ¶ 231. In the event that input owner is itself active in the downstream market, the key issue will be what constitutes a "few"

[59] Robert Pitofsky, et al., *supra* note 54, at 461.

competitors—for under this approach it is more likely that a negative effect on competition will be found if the refusal to supply "excludes one of its few competitors."

The Sections note that the European Court of Justice in its *IMS* decision[60] required that the refusal eliminate all competition in the secondary market; we question the departure from that standard in the Discussion Paper. Some courts in the United States have also required evidence that the refusal to supply must result in the relatively permanent elimination of all competition in the downstream market, not merely have a negative effect on competition.[61] A policy which allows for the finding of an abuse of dominance to exist based simply on the exclusion of one of a number of competitors, absent material adverse impact on price or non-price competition, is far too strict.

The Discussion Paper suggests that the assessment of whether a refusal to supply an input is justified will depend, at least in part, on whether the dominant firm would have made the investments related to the input even if it had known that it would be forced to supply the input. Presumably, this assessment would be made by the competition authority or court reviewing the case. In cases involving intellectual property rights, the Discussion Paper suggests that dominant firm would be likely to do so in cases where the innovations giving rise to the intellectual property rights may not have been "particularly significant."

A court or competition tribunal may find it a challenge to determine, on an objective basis, whether or not an invention is "particularly significant," and may lack technical competence to determine the circumstances under which private firms would be willing to make investments.[62] Apart from these concerns, there is the more fundamental question regarding whether courts and competition authorities should be engaged in second-guessing companies in this manner. Moreover, a subjective analysis could inject an element of uncertainty into the analysis of refusals to supply that the EU courts have sought to avoid in narrowly describing the circumstances in which a refusal to license is abusive.

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[60] *See* Case C-418/01, IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG, , 2004 E.C.R. I-5039. In its *IMS* decision, the European Court of Justice held that a dominant firm may be deemed to have abused a dominant position in refusing to grant access if: access is indispensable for carrying on a particular business and (i) the refusal prevents the emergence of a new product for which there is potential consumer demand; (ii) the refusal is not justified by objective considerations; and (iii) the refusal eliminates all competition in the secondary market. In order to determine whether a product or service is indispensable, the court considered whether there are products or services which constitute alternative solutions and "whether there are technical, legal or economic obstacles capable of making it impossible or at least unreasonably difficult" for the party requesting access to operate in the market, by itself or in cooperation with other firms.

[61] *See* Alaska Airlines, Inc. v. United Airlines, Inc., 948 F.2d 536, 554 n.11 (9th Cir. 1991) ("The power to eliminate competition must not be momentary, but must be at least relatively permanent."); Olympia Equip. Leasing Co. v. Western Union Telegraph Co., 797 F.2d 370, 379 (7th Cir. 1986).

[62] The notion that a tribunal would be positioned to determine whether a company would have made an investment even with knowledge that it would be forced to share the fruits of its investment effectively presumes that some investments are so risk-free or so sure of achieving high profits as to be certain to be made regardless of the circumstances. The Sections doubt that such investment opportunities often exist and that competition tribunals would have the ability to identify them accurately.

Intellectual Property Rights. The Discussion Paper recognizes that there is no general obligation to license intellectual property rights, that to impose an obligation to grant a license would deprive the owner of "the substance of the exclusive right," and that the refusal to grant a license "does not in itself constitute an abuse." ¶¶ 238-39.[63] The Discussion Paper provides an additional condition before the failure to license intellectual property rights can be deemed an exclusionary abuse: the undertaking which requests the license must intend "to produce new goods or services not offered by the owner of the right and for which there is a potential consumer demand" and not merely duplicate "the goods or services already offered on this market by the owner of the IPR." ¶ 239. The additional requirement is consistent with the ECJ's decision in *IMS* and EU jurisprudence according intellectual property rights granted under the laws of the Member States with greater protection.[64]

As discussed below, even with this additional requirement, it is not clear to the Sections that the broad imposition of an obligation to license intellectual property rights is warranted without proof of a separate violation, such as single branding or tying. Paragraph 240 of the Discussion Paper contains language that seems at odds with the current approach of forcing a dominant firm to grant a license only in a narrowly-defined set of circumstances. This paragraph suggests that a dominant firm may be required to license its intellectual property in situations where the company requesting the license wants to engage in follow-on research and development, even when this does not involve "clearly identifiable new goods and services." ¶ 240. Although the "indispensability" test in ¶ 240 may provide some protection for the IPR holder, we believe that this broad obligation goes beyond the existing case law as expressed in *Magill* and *IMS Health*, introduces an undesirable degree of uncertainty, and is likely to have a chilling effect on innovation in the long run contrary to the purpose of legislation recognizing intellectual property rights. When an innovator has rivals "who can readily absorb the ambient spillovers from its R&D expenditures, the amount invested in the creation of productive knowledge and in the development of the means for its effective utilization will tend to be less than the optimal amount."[65]

Some U.S. commentators have expressed serious concern about the application of the essential facilities doctrine in the intellectual property context.[66] Other commentators

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[63] See Case C-418/01, IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG, 2004 E.C.R. I-5039 at ¶ 34 ("According to settled case-law, the exclusive right of reproduction forms part of the owner's rights, so that refusal to grant a licence, even if it is the act of an undertaking holding a dominant position, cannot in itself constitute abuse of a dominant position…); Case 238/87 AB Volvo v. Erik Veng (UK) Ltd, 1988 E.C.R. 6211 ¶ 8; Cases 241 and 242/91, RTE & ITE v. Comm'n, 1995 E.C.R. I-743 ¶ 49.

[64] *See* Case C-418/01, IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG, 2004 E.C.R. I-5039; Case 238/87 AB Volvo v. Erik Veng (UK) Ltd, 1988 E.C.R. 6211; Cases 241 and 242/91, RTE & ITE v. Comm'n, 1995 E.C.R. I-743.

[65] William Baumol & Janusz Ordover, *Antitrust: Source of Dynamic and Static Inefficiencies?*, in ANTITRUST, INNOVATION, AND COMPETITIVENESS 83 (Thomas Jorde & David Teece eds., 1992).

[66] *See, e.g.*, Lipsky & Sidak, *supra* note 54; Marquardt & Leddy, *supra* note 54.

have argued that compulsory licensing of intellectual property rights should be imposed in appropriate situations.[67]

Laws protecting intellectual property provide incentives to market participants to innovate and thereby develop better products, more efficient processes, and original works of expression. Absent the right to exclude others from utilizing the fruits of an investment in innovation, economic actors may be less inclined to invest time and money in developing intellectual property rights, such as copyrights, patents, and trade secrets. Indeed, some U.S. courts have held that the desire of an owner of intellectual property rights to be the exclusive user of its original work is a presumptively legitimate business justification for a refusal to license to competitors.[68]

While enforcement of intellectual property rights may seemingly reduce competition in the short term, this effect is often likely to be surpassed by the long-term procompetitive benefits of sound intellectual property laws and enforcement. Depending on the circumstances, forcing the owner of intellectual property to grant a license deprives the owner of its "legitimate" award, and can chill desirable activities such as research, development, and commercialization of desirable inventions.

These considerations have led some to conclude that an excessively liberal application of the essential facilities doctrine would be antithetical to the common paramount goal shared by intellectual property policy and competition policy. Commentators have also noted that, while the essential facilities doctrine has been pled in several cases in the context of intellectual property, no U.S. court has held that a

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[67] *See* Robert Pitofsky, *et al.*, *supra* note 54, at 461 ("In those rare and exceptional circumstances where a facility is truly essential to competition, the anticompetitive effects of denial of access are severe, and there is no business justification (and particularly when there is evidence of a specific intent to injure a rival), U.S. courts will impose antitrust liability for a monopolist's refusal to license access to an essential facility. The same result obtains in those circumstances where intellectual property …is shown to constitute an essential facility…".

[68] *See* In re Indep. Serv. Orgs. Antitrust Litig., 203 F.3d 1322, 1327 (Fed. Cir. 2000)("In the absence of any indication of illegal tying, fraud in the Patent and Trademark Office, or sham litigation, the patent holder may enforce the statutory right to exclude others from making, using, or selling the claimed invention free from liability under the antitrust laws."); A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004, 1026-27 & n.8 (9th Cir. 2001); Data Gen. Corp. v. Grumman Sys. Support Corp., 36 F.3d 1147, 1186-87 (1st Cir. 1994) ("[I]n passing the Copyright Act, Congress itself made an empirical assumption that allowing copyright holders to collect license fees and exclude others from using their works creates a system of incentives that promotes consumer welfare in the long term by encouraging investment in the creation of desirable artistic and functional works of expression. . . . *We cannot require antitrust defendants to prove and reprove the merits of this legislative assumption in every case where a refusal to license a copyrighted work comes under attack."*) (emphasis added). *See also* Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property § 2.2 (1995) ("As with any other tangible asset that enables its owner to obtain significant supracompetitive profits, market power (or even a monopoly) that is solely 'a consequence of a superior product, business acumen, or historic accident' does not violate the antitrust laws. *Nor does such market power impose on the intellectual property owner an obligation to license the use of that property to others.*") (citation omitted; emphasis supplied); ALD, *supra* note 2, at 1077 & notes (collecting cases).

unilateral refusal to license intellectual property rights, alone, served as actionable exclusionary conduct.[69]

The Commission should consider seriously the potential effects of the application of the standard on refusal to supply to the licensing of intellectual property rights and should suggest that the proposed standards for finding an exclusionary abuse not apply to the refusal to license intellectual property rights at all or only in extraordinary exceptional circumstances.

D. Interoperability Information

The Discussion Paper notes that "leveraging market power from one market to another by refusing interoperability information may be an abuse of a dominant position." ¶ 241. Paragraph 242 then suggests that, with respect to matters of ensuring technological compatibility, a refusal to disclose trade secrets may not be held to the same high standards as a refusal to license other intellectual property rights, such as a copyright or patent.

Some may contend that the public policy grounds for granting protection to trade secrets are different from the grounds for the protecting of copyrights, patents and trademarks and that trade secrets are entitled to less protection because while trade secrets encourage innovation in a general sense, there is no requirement that a trade secret involve any specified degree of innovation,[70] and that where the primary economic advantage of the secret is to exclude competitors from neighboring markets, requiring the disclosure of a trade secret does not raise the same level of concerns as the compulsory license of a patent or copyright.

The public policy considerations concerning the protection of trade secrets are of the same nature as the public policy considerations applicable to the protection of other intangible property rights, such as copyrights, patents, and trademarks. Such property rights are recognized and protected in order to provide incentives for the owners of those property rights. Indeed, the policy reasons to protect trade secrets may be even more compelling than the reasons why patents should not be subject to compulsory licensing. If a dominant company is required to grant a patent license, it can receive a reasonable royalty and its rights in the patented invention itself are not jeopardized. By contrast, the

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[69] Some U.S. courts hold that a unilateral refusal to license intellectual property can never be the basis for an antitrust claim, while others have ruled that a unilateral refusal to license is presumptively lawful, but the presumption may be overcome in limited circumstances. *See* ALD, *supra* note 2, at 1076-79 (collecting cases).

[70] *See e.g.*, ROGER M. MILGRAM, MILGRIM ON TRADE SECRETS § 1.01[1](2005)(citing RESTATEMENT (FIRST) OF TORTS§ 757 cmt b (1939) ("Novelty and invention are not requisite for a trade secret as they are for patentability. These requirements are essential to patentability because a patent protects against unlicensed use of the patented device or process even by one who discovers it properly through independent research. The patent monopoly is a reward to the inventor. But such is not the case with a trade secret. Its protection is not based on a policy of rewarding or otherwise encouraging the development of secret processes or devices. The protection is merely against breach of faith and reprehensible means of learning another's secret.").

value of trade secrets would be destroyed if the information became generally known.[71] In many cases, trade secrets are more valuable than patent rights, especially in circumstances where the basic technology is well understood but the means of implementing it is an art as much as a science.

Trade secrets encompass virtually anything that a company owns that has a value to that company in conducting its business activities. Companies must take reasonable measures to maintain the confidentiality of the information. Trade secrets include patentable inventions. In such a situation, the owner of an invention could either file a patent application to protect the invention as a trade secret. The protection provided by a patent is different from the protection provided by a trade secret and it is not necessarily any greater. The patent application would disclose sufficient details about the invention to allow one skilled in the relevant art to reproduce the invention. If granted, protection would be provided for a specified term and only in the jurisdictions covered by the patent application or applications. An alternate course of action would be to protect the invention as a trade secret. Unlike a patent, there is no limit on how long a trade secret can be preserved. For example, Coca-Cola has successfully maintained the confidentiality of its formula for over one hundred years. A company possessing an invention that could be protected as either a trade secret or a patent would weigh the relative advantages and disadvantages of each approach. A key issue would be whether other companies could determine the invention/trade secret when the product is sold or used.

Furthermore even in those situations where a patent could not be obtained for a trade secret, unnecessarily requiring disclosure of trade secrets can destroy significant value and have the same chilling effect on innovation as compulsory patent or copyright licensing. A very significant portion of R&D expenditure results in inventions that, while not patented or patentable, are nonetheless innovative. In particular, implementation details are often the product of very significant investment in R&D and in some cases may be as valuable or be more valuable than patent rights.

The position in the Discussion Paper is premised on the unstated assumption that interoperability information is necessarily devoid of inventive or creative content, much like the television listings at issue in *Magill.* In fact, although some interoperability information may be arbitrary in nature, such as the precise signal that is used for two devices to interconnect, interoperability information may embody significant inventive content. For example, although the precise signal that is used for such an interconnection might be arbitrary (in the sense that whether a device handshake is initiated by a sequence of 1-2-3 or 3-2-1 or some other sequence is arbitrary), the manner in which such an interconnection is achieved may not be. Courts and regulators are not well

[71] *See* RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39 (1995) ("A trade secret is any information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others.") Unlike copyrights, trademarks and patents, a trade secret derives its value from being kept confidential. A party wishing to protect a trade secret is required to undertake reasonable measures to protect the information, but no measures need to be taken in terms of registering the property.

placed to decide whether an interface is "innovative" or "arbitrary". If they make the wrong determination, they will deny firms the value of their innovations, creating uncertainty and potentially chilling innovation.

The Discussion Paper expresses concern that a dominant company may leverage market power from one market to another by refusing to supply interoperability information. Where such conduct is otherwise unlawful under Article 82, and where the commercial value of the claimed trade secret is derived only from the fact that competitors need it to develop interoperable products, *i.e.*, it is otherwise lacking significant inventive content, the Sections agree that the potential status of the information as a trade secret should not provide a defense. Otherwise, given the potential for compulsory disclosure of trade secrets to destroy value and impede innovation, the Sections believe that trade secrets are entitled to the same level of protection provided to other intellectual property rights.

VII. AFTERMARKETS

The Sections commend the Commission for including guidance in the Discussion Paper on the application of Article 82 to aftermarkets. The treatment of aftermarkets is particularly important for firms supplying capital equipment that requires periodic replacement parts and service as well as firms manufacturing durable goods that use related consumable products to perform their intended functions.

As the Discussion Paper notes, it is common for the supplier of such equipment to have "a very strong position" in the sale of "secondary" products and services used with its own brand of equipment. ¶ 253. Indeed, firms with smaller positions in the primary equipment market may have even larger shares of their brand's aftermarket because third-party suppliers and other primary market firms typically focus on the most successful equipment brands since those brands provide the largest aftermarket revenue opportunity. As a result, there is a risk that firms with quite modest positions in the primary market would be viewed as dominant in the aftermarket if the assessment were to be focused only on an aftermarket consisting of products and services for their individual brand of equipment.

The Sections believe that the Discussion Paper is correct in emphasizing that the "secondary markets" should not be viewed in isolation since "the actual degree of market power of the supplier [in the aftermarket] … may be constrained by competition in the primary market." ¶ 246. As the Discussion Paper explains, "competition in the primary market may make price increases in the aftermarket unprofitable due to its impact on sales in the primary market, unless prices in the primary market are lowered to offset the higher aftermarket prices." ¶ 246. This fundamental insight regarding the key relationship between the primary market and any related aftermarkets means that a separate examination of a single brand aftermarket under Article 82 is rarely, if ever, appropriate.[72]

[72] As the United States Department of Justice explained in a brief to the U.S. Supreme Court in the *Kodak* case, "[b]ecause it is not disputed that Kodak lacks market power in the market for equipment ..., the

The Discussion Paper appears to accept this conclusion for "customers who may buy the primary product in the future" since competition in the primary market will protect such customers.[73] *See* ¶¶ 254-59. However, the Discussion Paper draws a distinction between "future customers" and "prior purchasers" on the basis that "competition in the primary market does not protect customers who have already bought the primary product." ¶ 254. The Sections believe that no meaningful distinction can be made between "future customers" and "prior purchasers."[74] Since every "prior purchaser" was, by definition, a "future customer" before it acquired the primary product, competition in the primary product market also protects this subset of customers. In addition, as noted in the Discussion Paper, the "prior purchasers" are also protected by the supplier's interest in its reputation with respect to its aftermarket pricing and practices because its reputation will affect its future sales of the primary product as well as its future sales of other equipment that requires aftermarket products and services. ¶ 262.

The Sections believe that the complex, multi-step analysis of aftermarkets set forth in the Discussion Paper[75] is both unnecessary and counterproductive. The

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suggestion that it nonetheless could exercise market power in a market for replacement parts or service for Kodak equipment is inherently implausible." Eastman Kodak Co. v. Image Technical Services, Inc, Brief for the United States as Amicus Curiae at 4 (Jan. 4, 1990). The United State Supreme Court in *Kodak* rejected the argument that as a matter of law there can never be a separate, single-brand aftermarket when a supplier lacked market power in the primary equipment market, holding that a case-by-case examination of the facts was required. *See* Eastman Kodak Co. v. Image Technical Services, Inc, 504 U.S. 451 (1992).

[73] Customers can protect themselves by comparing the lifecycle costs of the products thereby taking into account both the initial cost of the primary product and the anticipated aftermarket costs over the useful life of the product. Often customers use long-term maintenance contracts or other contractual guarantees regarding the lifecycle cost of the product to protect themselves against the impact of subsequent changes in aftermarket prices or policies. Sophisticated customers (referred to in the Discussion Paper as "professional buyers," ¶ 258), are more likely to engage in this practice than individual consumers. However, consumers may use extended warranties or other contractual arrangements to protect themselves.

Even where customers lack information or sophistication to compare lifecycle costs or to negotiate contractual protections, competition among suppliers will normally protect purchasers. Since suppliers can be expected to understand the long-term revenue opportunity flowing from the sale of the primary product, they are likely to compete aggressively in pricing their primary products in the expectation of obtaining a stream of aftermarket revenues from the primary equipment sale. *See* ¶ 259.

[74] Of course, many customers are repeat purchasers of the primary product and thus are both "prior purchasers" and potential "future customers." A customer may well be able to protect itself with respect to the impact of "policy changes" with respect to its prior purchases when it negotiates for its next purchase of the primary product. *See* ¶ 254 n.146.

[75] The first step in the approach set forth in the Discussion Paper is to determine whether there is a separate single-brand aftermarket. This focuses only on customers that have already purchased the primary product and asks whether it is possible for such customers (1) to switch to the secondary products provided by other primary market suppliers or (2) to switch to another brand of the primary product in order to defeat an attempt by the supplier of the primary product to increase prices of its secondary products or services. In many cases, this step will lead to defining a single-brand aftermarket. Only in the second step of the proposed approach – determining "dominance" in the single-brand aftermarket -- is the impact of competition in the primary market taken into account. Here, the Discussion Paper appears to require a separate assessment be made of "customers who have already bought the primary product" ¶ 254) and appears to treat ease of entry as the only factor that would keep a supplier with a "very strong position on the aftermarket" for its own brand of equipment from being viewed as "dominant" for this group of customers. While suggesting that "the weaker the position of the supplier in question on [the primary]

Attachment

Comments of the Section of Antitrust Law of the American Bar Association in Response to the Antitrust Modernization Commission's Request for Public Comment Regarding Exclusionary Conduct

Comments of the Section of Antitrust Law
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Antitrust Modernization Commission's
Request for Public Comment
Regarding Exclusionary Conduct

The Section of Antitrust Law ("Antitrust Section") of the American Bar Association ("ABA") is pleased to submit these comments to the Antitrust Modernization Commission (the "Commission") in response to its request for public comment dated May 19, 2005 regarding specific questions relating to Exclusionary Conduct selected for study by the Commission. The views expressed herein are being presented on behalf of the Antitrust Section. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association.

Summary of Comments

The Antitrust Modernization Commission's ("AMC") call for comments on the standards for exclusionary conduct was both general and specific. As a general matter, the AMC asked:

> *How should the standards for exclusionary or anticompetitive conduct be determined (e.g., through legislation, judicial development, amicus efforts by DOJ and FTC), particularly if you believe the current standards are not appropriate or clear?*

More specifically, the AMC called for comments on the current standards regarding (1) refusals to deal; (2) the essential facilities doctrine; and (3) bundling and bundled pricing.

A. GENERAL STANDARDS

In answering the question "how should the standards for exclusionary or anti-competitive conduct be determined," the Antitrust Section's outline concludes that statutory change is unnecessary.

On the whole, viewed historically, there is broad agreement on the general legal framework for the three offenses prohibited under Section 2 of the Sherman Act. However, there is a lively and continuing debate about the specific standards for distinguishing exclusionary or predatory conduct from aggressively competitive behavior. The Section concludes, however, that areas of consensus on the application of Section 2 are wider than areas of disagreement.

The Supreme Court's recent decision in *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) summarizes and restates the proposition that possession of a monopoly is lawful, and only acquiring or perpetuating monopoly power through exclusionary means is unlawful. This concept is taken for granted today, although prior decisions examined the fundamental question whether liability could be imposed for the exercise of monopoly power alone, or whether monopoly power plus anticompetitive conduct must be demonstrated. *See, e.g., Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), *United States v. Grinnell Corp.*,384 U.S. 563 (1966), and *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

Similarly, the courts and enforcement authorities agree that we do not impose on monopolists affirmative duties to share with or to assist competitors except in rare circumstances, such as in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), where there was a prior course of dealing and the refusal suppressed competition. Refusals to deal in and of themselves only rarely constitute predatory or exclusionary conduct and are otherwise generally lawful.

It is also well-established that Section 2 may not be used to de-monopolize a monopolized market absent a finding that the monopoly was either acquired or maintained unlawfully. By preventing exclusionary conduct to acquire or maintain a monopoly, we preserve the role of market forces in de-monopolizing markets. Monopolists should be subject to liability under Section 2 only when they engage in predatory or exclusionary conduct.

No studies suggest that public or private enforcement of Section 2 has systematically failed to prevent anticompetitive conduct or deterred beneficial conduct by firms with dominant market positions. A review of enforcement statistics suggests that government Section 2 cases have been extremely rare, and have been filed with decreasing frequency over the years.

Finally, although there has been a lively debate among parties to litigation, academics and other observers and commentators in recent years on the question whether there should be a unitary standard for identifying exclusionary or predatory conduct, a single standard that would be appropriate for all exclusionary conduct has not been identified and is not needed to correct the state of Section 2 jurisprudence and ensure the protection of consumer welfare. Hence, the courts should be permitted to continue to evolve appropriate standards on a case-by-case basis, as particular conduct and facts present themselves for consideration.

B. **SPECIFIC AREAS OF AMC INTEREST**

The Antitrust Section outline also studied the current state of the law and economics as to the three specific areas identified by the AMC:

(1) Liability for refusals to deal with rivals in the absence of a regulatory regime that specifically governs competitive behavior;

(2) The continued role, if any, of the essential facility doctrine; and

(3) Product bundling and bundled prices.

The outline concludes that in the absence of consensus and in light of the trend in the courts to use these doctrines sparingly, it is unnecessary for the Commission to seek legislative reform pertaining to either (1) refusals to deal or (2) the essential facility doctrine. Improvements may be sought when necessary through the filing of amicus briefs in specific cases and/or through agency guidelines. With respect to (3) product bundling and bundled pricing, the outline concludes that there is no consensus as to the correct standard at this time because their competitive effects are not clear in all circumstances. Therefore, further refinement of the treatment of bundling and bundled pricing should be left to common law development under the Sherman Act.

Exclusionary Conduct Standards

A. GENERAL OBSERVATIONS

1. On the whole, viewed historically, there is broad agreement on the general legal framework for the three offenses prohibited under Section 2 of the Sherman Act. However, there is a lively and continuing debate about the specific standards for distinguishing exclusionary or predatory conduct from aggressively competitive behavior.

   a. Areas of consensus on the application of Section 2 are wider than areas of disagreement.

   b. *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) ("*Trinko*") summarizes and restates the proposition that having a monopoly is lawful, and only acquiring or perpetuating monopoly power through exclusionary means is unlawful. This concept is taken for granted today, although prior decisions examined the fundamental question whether liability could be imposed for the exercise of monopoly power alone, or whether monopoly power plus anticompetitive conduct must be demonstrated. *See, e.g., Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), *United States v. Grinnell Corp.*,384 U.S. 563 (1966), and *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

   c. Similarly, the courts and enforcement authorities agree that

      (i) We do not impose on monopolists affirmative duties to share with or to assist competitors except in rare circumstances, such as in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), where there was a prior course of dealing and the refusal suppressed competition;

      (ii) Refusals to deal in and of themselves only rarely constitute predatory or exclusionary conduct and are otherwise generally lawful;

(iii) Section 2 may not be used to de-monopolize a monopolized market absent a finding that the monopoly was either acquired or maintained unlawfully;

(iv) By preventing exclusionary conduct to acquire or maintain a monopoly, we preserve the role of market forces in de-monopolizing markets;

(v) Monopolists should be subject to liability under Section 2 when they engage in predatory or exclusionary conduct.

d. No studies suggest that public or private enforcement of Section 2 has systematically failed to prevent anticompetitive conduct or deterred beneficial conduct by firms with dominant market positions.

(i) A review of enforcement statistics suggests that government Section 2 cases have been extremely rare, and have been filed with decreasing frequency over the years. *See, e.g.*, U.S. Dep't of Justice, *Workload Statistics, FY 1995-2004, available at* http://www.usdoj.gov/atr/public/workstats.htm; William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Norms*, 71 ANTITRUST L.J. 377, 478 (2003) (AAppendix A@) (Professor Kovacic=s data on FTC antitrust non-merger cases covers January 1961-July 2003). *See also* Steven C. Salop & Lawrence J. White, *Private Antitrust Litigation: An Introduction and Framework*, *in* LAWRENCE J. WHITE, ED., PRIVATE ANTITRUST LITIGATION: NEW EVIDENCE, NEW LEARNING 3, 4 (1988) (collecting data from 1941-84).

e. Despite lively debate among parties to litigation, academics and other observers and commentators, it is difficult to articulate a single standard that would be appropriate for all exclusionary conduct or that is needed to correct the state of Section 2 jurisprudence and ensure the protection of consumer welfare.

B. SUMMARY OF CONCLUSIONS

a. In several relatively limited respects, clarification of the law could be useful, but none of these appear to warrant a broadly-applicable statutory change. Clarification could be accomplished through agency enforcement guidelines and agency amicus efforts to assist judicial development in the following areas:

(i) Liability for refusals to deal with rivals in the absence of a regulatory regime that partially governs competitive behavior;

(ii) Liability for refusals to deal under the "essential facilities" doctrine;

(iii) Product bundling and bundled pricing, which have been the subject of several recent decisions that may lead to under and/or over-deterrence arising from advice of counsel in the face of uncertainty;

(iv) The continuing split of authority among the Federal Circuit and the other Circuit Courts of Appeal regarding the role of Section 2, if any, in policing refusals to license IP. There may also be differences of approach as between the Federal Circuit in the United States and the European Union. Conditional refusals to deal, as in IP licensing, such as "no license if licensee also deals with rival," may violate Section 2. Should the refusal to license intellectual property rights, without more, ever be found to violate Section 2?

C. OVERVIEW OF ISSUES IN CONTROVERSY

1. Individual case comparisons can give rise to the appearance that standards for bringing Section 2 enforcement cases against allegedly unlawful exclusionary conduct may vary among and between the DOJ, the FTC, and State Attorneys General. *See, e.g.,* enforcement decisions by the DOJ and the FTC and the States in connection with Microsoft. On balance, however, such comparisons may not support any valid generalizations.

   a. Some commentators contend that efficient, pro-competitive business conduct will be encouraged if clear enforcement standards for Section 2 are established. Such commentators criticize the standard for liability offered in the DOJ/FTC amicus brief in *Trinko* as offering insufficient guidance for business decision-makers.

   b. Under one view, the standards for government enforcement of Section 2 might be confusing if the *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181 (3d Cir. 2005), which the DOJ prosecuted as an exclusive dealing case, were to be interpreted as a "duty to deal" case. For the most part, however, commentators have characterized the *Dentsply* case as one in which exclusive dealing restrictions were used to prevent erosion of a monopoly position.

2. A survey of scholarly work and recent briefs filed by federal enforcement agencies and private *amici* reveals a relatively broad range of views on the problem of assessing the competitive effects of exclusionary conduct. *See, e.g.*:

   a. Ayres, Ian & Nalebuff, Barry, *Going Soft on Microsoft? The EU's Antitrust Case and Remedy*, 2 The Economist's Voice, Article 4 (2005).

   b. Bork, Robert H., THE ANTITRUST PARADOX (1978, rev. 1993).

c. Briefs for the United States and other *amici* in *Verizon Communications v. Trinko*, and Briefs for the United States in *United States v. Dentsply*, *United States v. Microsoft Corp*. and Brief of the United States as Amicus Curiae in Opposition to the Petition for a Writ of Certiorari in *LePage's v. 3M*.

d. Creighton, Susan A., Hoffman, D. Bruce, Krattenmaker, Thomas and Nagata, Ernest, *Cheap Exclusion: Fishing Where the Fish Are: FTC Antitrust Law Enforcement and the Anticompetitive Acquisition of Market Power by Low-cost Means*, 72 Antitrust L.J. 975 (2005).

e. Easterbrook, Frank H., *When Is It Worthwhile to Use Courts to Search for Exclusionary Conduct?*, 2003 Colum. Bus. L. Rev. 345 (2003).

f. Edlin, Aaron S., *Stopping Above-Cost Predatory Pricing*, 111 Yale L.J. 941 (2002).

g. Elhauge, Einer, *Why Above-Cost Price Cuts to Drive Out Entrants Are Not Predatory – and the Implications for Defining Costs and Market Power*, 112 Yale L.J. 681 (2003) (response to Edlin).

h. Elhauge, Einer, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. 253 (2003).

i. Evans, Davis S. & Padillia, A. Jorge, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. Chi. L. Rev. 73 (2005) (Part of Symposium).

j. Gavil, Andrew I., *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 Antitrust L.J. 3 (2004).

k. Jacobson, Jonathan M., *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 Antitrust L.J. 311 (2002).

l. Hovenkamp, Herbert, *Exclusion and the Sherman Act*, 72 U. Chi. L. Rev. 147 (2005) (Part of Symposium).

m. Lao, Marina, *Reclaiming a Role for Intent Evidence in Monopolization Analysis*, 54 Am. U. L. Rev. 151 (2005).

n. Leary, Thomas B., Commissioner, Federal Trade Commission, *The Need for Objective and Predictable Standards in the Law of Predation*, speech before the Steptoe & Johnson and Analysis Group/Economics 2001 Antitrust Conference, Washington, D.C. (May 10, 2001).

o. Meese, Alan, J., Monopolization, *Exclusion, and the Theory of the Firm*, 89 Minn. L. Rev. 743 (2005).

p. Melamed, A. Douglas, Global Competition Review , Vol. 7, Issue No. 2 at 16 (roundtable discussion of Verizon v. *Trinko* with twelve other participants).

q. Melamed, A. Douglas, *Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal*, 20 Berkeley Tech. L.J. 1247 (2005).

r. Ordover, Janusz A. & Willig, Robert D., *An Economic Definition of Predation: Pricing and Product Innovation*, 91 Yale L.J. 8 (1981).

s. Pate, R. Hewitt, Address: *The Common Law Approach and Improving Standards for Analyzing Single Firm Conduct*, October 23, 2003, *available at* http://www.usdoj.gov/atr/public/speeches/202724.htm.

t. Scheffman, David T & Higgins, Richard S., *20 Years of Raising Rivals' Costs: History, Assessment and Future* (discussion paper) *available at* http://www.ftc.gov/be/RRCGMU.pdf.

u. Salop, Steven C. & Romaine, R. Craig, *Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft*, 7 Geo. Mason. L. Rev. 617 (1999).

v. Salop, Steven C., Section 2, *Consumer Welfare Effects, and the Flawed Profit-Sacrifice Standard*, presentation CRA International Seminar, May 18, 2005 (article forthcoming in the Antitrust Law Journal).

3. A handful of relatively recent cases have fueled the debate over Section 2 standards.

a. *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004)
b. *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001)
c. *Le Page's Inc. v. 3M Co.*, 324 F.3d 141 (3d Cir. 2003)
d. *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181 (3d Cir. 2005)
e. *United States v. AMR Corp.*, 335 F.3d 1109 (10th Cir. 2003)
f. *Confederated Tribes of Siletz Indians v. Weyerhaeuser Co.*, 411 F.3d 1030 (9^{th} Cir. 2005)

4. The core of the debate centers on the question how to find a standard that strikes an appropriate balance between over-deterrence, which would chill legitimately aggressive competitive conduct, and under-deterrence, which would result in competitive harm that reduces consumer welfare. Courts have articulated the issue variously:

a. "The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The Supreme Court has maintained that the opportunity to charge monopoly prices – at least for a short period – is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive conduct." *Trinko,* 540 U.S at 879.

b. The purpose of the Act is not to protect business from the working of the market, it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself. It does so not out of solicitude for private concerns but out of concern for the public interest. *Spectrum Sports*

5. Some disagreement exists among experts as to whether the ability to charge monopoly profits indeed induces risk taking, innovation and economic growth. Nevertheless, Justice Scalia's observation represents the Supreme Court's most recent pronouncement on how monopoly power ought to be viewed as a matter of antitrust policy. Thus, when combined with the teaching of *Spectrum Sports, Trinko* suggests that Section 2 ought to be construed as imposing liability only as necessary to protect consumer welfare against a failure of the competitive market process when the failure is caused by acquisition or perpetuation of monopoly power by means of exclusionary conduct.

6. The facts, reasoning, and specific holding in *Trinko,* which involved a refusal to assist a rival in the context of a regulatory scheme that mandated cooperation, suggest that its specific holding is most clearly applicable to similarly-regulated industries. Nevertheless, the *Trinko* opinion contains language that more broadly characterizes the purposes of the antitrust laws in general, and suggests limitations on the application of Section 2. It is unclear whether and how these observations by the *Trinko* Court ought to influence the analysis of Section 2 cases outside regulated industries.

a. *Aspen Skiing* was reaffirmed, but identified as "at the outer limit" of conduct that violates Section 2.

b. The viability of, or the need for, an essential facilities doctrine was called into question.

c. The viability of "leveraging" apart from proof of either attempt to monopolize or monopolization was disapproved; and

d. The exercise of monopoly power by itself was held to be insufficient to violate the statute.

7. Beyond its holding – that a refusal to assist a rival by a firm already subject to a regulatory duty to do so, does not itself constitute an independent violation of Section 2 – *Trinko* did not answer the dilemma articulated by the D.C. Circuit in *Microsoft*:

   a. "Whether any particular act of a monopolist is exclusionary, rather than merely a form of vigorous competition, can be difficult to discern: the means of illicit exclusion, like the means of legitimate competition, are myriad. The challenge for an antitrust court lies in stating a general rule for distinguishing between exclusionary acts, which reduce social welfare, and competitive acts, which increase it." *United States v. Microsoft Corp*., 253 F.3d 34, 58 (D.C. Cir. 2001).

8. Antitrust economists and other commentators have presented a range of economic models for analyzing different categories of exclusionary conduct, and there is disagreement as to the balance any of these analyses would strike between over- and under-deterrence. Except in the context of case-specific fact scenarios, it is unclear how such analytical models would assist generally in the development of legal doctrine.

9. What are the possible standards that could be used to define exclusionary conduct that violates Section 2?

   a. <u>Profit sacrifice.</u> The test looks for a departure from profit maximization and has been cited by some courts as critical evidence of exclusionary conduct. Some commentators argue that it should be a necessary condition for a finding of liability associated with all forms of exclusionary conduct. The current test for predatory pricing is an example of profit sacrifice, but is not co-extensive with the profit sacrifice test. For purposes of predatory pricing, a firm must sacrifice *all* profits, whereas profit sacrifice would also reach conduct that involves some sacrifice but is not necessarily below cost.

      (i) Cases: *Aspen*. The conduct was exclusionary because the defendant "was willing to sacrifice short-run benefits and goodwill in exchange for a perceived long-run impact on its smaller rival." *Aspen*, 472 U.S. at 610-11; *see Trinko*, 540 U.S. at 409 (*Aspen* defendant demonstrated "a willingness to forsake short-term profits to achieve an anticompetitive end"); *Covad Communications Co. v. Bell Atlantic Corp.*, 398 F.3d 666, 676 (D.C. Cir. 2005) ("a 'predatory' practice is one in which a firm sacrifices short-term profits in order to drive out of the market or otherwise discipline a competitor"); *MetroNet Services Corp. v. Qwest Corp.*, 383 F.3d 1124, 1134 (9th Cir. 2004).

(ii) Issues. Is sacrifice an appropriate test for any kind of exclusion other than predatory pricing, given its sole focus on the effects of the conduct on the monopolist? Should it be necessary also to consider the effect of the conduct on rivals? On consumers? What justifies foregoing an analysis of effects in predatory pricing cases? Do those same factors necessarily apply to other forms of exclusionary conduct? Are there instances of objectionable exclusion that involve little or no profit sacrifice, or that involve simultaneous or prompt recoupment? Should profit sacrifice be a necessary condition for all forms of exclusion, or just a sufficient one in appropriate cases? What is the justification for requiring that firms sacrifice any legitimate benefit to help rivals or consumers? *Trinko* indicates that the Supreme Court is skeptical of *Aspen*, saying that its standard is at or near the outer limits of Section 2.

(iii) Short run profit sacrifice can over-deter as well as under-deter. Short-run profit sacrifice can be an important element in establishing that conduct is exclusionary, but it cannot be sufficient to make conduct exclusionary, because procompetitive conduct, such as R&D or purchasing capital equipment, entails the sacrifice of current profit in the pursuit of greater profit over the longer term. Moreover, some have cautioned that any focus on short-run profit sacrifice should be used cautiously so as to avoid any unintended signal that the antitrust laws will judge monopoly behavior favorably if it involves short-run profit maximization.

b. <u>No economic sense</u>. This test is related to the profit sacrifice test. As advocated by the DOJ, "conduct is not exclusionary or predatory unless it would make no economic sense for the defendant but for the tendency to eliminate or lessen competition." DOJ has advocated this test in all types of Section 2 cases.

(i) Cases. *Microsoft*: DOJ argued that a course of conduct that served to protect the defendant's operating system monopoly was exclusionary because it "would not make economic sense unless it eliminated or softened competition." *American Airlines*: DOJ contended that the defendant drove out rivals by adding "money-losing capacity" and that "distinguishing legitimate competition from unlawful predation requires a common-sense business inquiry: whether the conduct would be profitable, apart from any exclusionary effects." *Dentsply*: DOJ argued that the defendant's policies of not using dealers that distributed products of rivals "made no economic sense but for their tendency to harm rivals," because the policies cost the defendant something, yet produced no possible benefit other than reducing competition. *Verizon*: DOJ and FTC at first appeared to endorse a "but for" test for all forms of exclusionary conduct in the certiorari briefs, but later retreated in the merits briefs, suggesting a far more circumscribed role for the test.

(ii) The test also defines a necessary condition for finding exclusionary conduct: Unless challenged conduct with a demonstrated tendency to eliminate competition would make "no economic sense" but for that tendency, the conduct cannot be characterized as "exclusionary."

(iii) Issues. Is the "no economic sense" test any better a barometer of exclusionary conduct than the profit sacrifice test? When might the two tests produce different results? As with profit sacrifice, does the no economic sense test suffer from an undue focus on the effects of the questioned conduct on the alleged monopolizer to the exclusion of its effects on rivals and consumers? How would the no economic sense test address conduct that is efficient for the monopolizer, and hence might be undertaken regardless of the tendency to eliminate competition, but that also facilitates the exercise of market power by having a significant exclusionary effect on rivals? If it is an appropriate test for some circumstances, such as a refusal to assist rivals, should it be generalized into a test for other circumstances? This standard preserves freedom of action for defendant firms with monopoly shares, which under the standard have no duty to make the market more beneficial for consumers, much less assist rivals, but instead proscribes only conduct that is anticompetitive and not (otherwise) beneficial to the defendant.

c. <u>Less efficient rival.</u> Under this approach, conduct is not exclusionary unless it is likely to exclude an equally or more efficient competitor.

(i) Administratively very difficult.

(ii) Advocated by Judge Posner in his treatise, but not adopted by any courts as proposed by Posner. *See* RICHARD A. POSNER, ANTITRUST LAW 194-95 (2d ed. 2001).

(iii) Some have advocated that it be incorporated as a factor into other tests, such as profit sacrifice. It is argued that even if there is profit sacrifice, conduct should be actionable only if it excludes an equally or more efficient rival.

(iv) Some have advocated a related test which looks to the impact of the conduct on the efficiency of the monopolist. (Elhauge).

(v) Issues. Focuses on efficiency of target of conduct instead of efficiency of conduct itself. Ignores possibility that welfare consequences of exclusion of a less efficient rival may be detrimental, as when the excluded rival is impaired before it reaches minimum efficient scale, or if the less efficient rival is keeping price below the monopoly level.

d. <u>Balancing</u>. Under a balancing test, a court would evaluate both the negative effects of the questioned conduct on rivals and consumers and its efficiency benefits for the alleged monopolizer, in order to determine whether on balance the conduct harms consumer welfare more than it benefits the monopolizer. The "Disproportionality" variant of the test would only prohibit conduct when its anticompetitive effects substantially outweigh its benefits. This approach is sometimes analogized to the rule of reason under Section 1 of the Sherman Act.

(i) Case law. In *Microsoft*, the D.C. Circuit endorsed a four part framework for analyzing allegedly exclusionary conduct. First, the conduct must harm competition, not just a rival of the alleged monopolist. Second, the plaintiff, who bears the burden of proof, must demonstrate that the monopolist's conduct indeed produced such an anticompetitive effect. At that point, the plaintiff has established a *prima facie* case, and the burden of production shifts to the monopolist, who may proffer a procompetitive justification. If the monopolist fails to do so, the plaintiff should prevail. But if it is able to do so, i.e., if it produces evidence to support "a nonpretextual claim that its conduct is indeed a form of competition on the merits," the burden of production shifts back to the plaintiff. At that point, the plaintiff must demonstrate that the anticompetitive effects of the conduct outweigh its procompetitive benefit. The court indicated that if the inquiry reaches this fourth step, it can be characterized as similar to rule-of-reason analysis under Section 1. 253 F.3d 34, 59. Finally, the D.C. Circuit indicated that evidence of intent may also be relevant, but only to the extent it illuminates the likely effect of the monopolist's conduct.

(1) Some have questioned whether *Trinko* may have undercut the viability of a balancing test by opining that Section 2 "does not give judges carte blanche to insist that a monopolist alter its way of doing business whenever some other approach might yield greater competition."

(2) Others have defended the *Microsoft* framework as a workable and economically defensible approach to Section 2 analysis that takes into account shifting burdens of production and is consistent with the larger body of Section 2 decisions of the Court. It also provides a basis for deciding cases that may involve conduct that produces some efficiency but also has substantial anticompetitive effects.

(ii) Issues. On the one hand, unlike the profit-sacrifice and no economic sense tests, the balancing test more clearly seeks to assess the effect of the questioned conduct on competition. However, it is subject to some of the same uncertainties as the rule of reason. Balancing may be more difficult than it sounds, and hence it may be difficult for a firm to predict its risk in advance of undertaking conduct that, although arguably pro-competitive, has some level of anticompetitive effect. If that is the case, a balancing test may deter competitively beneficial or benign conduct. Also, in the context of refusals to deal, this standard may risk imposing on firms a duty to help competitors even when those competitors fail to take reasonable steps to compete without the assistance of the larger rival.

e. Miscellaneous other issues.

(i) <u>Essential facilities doctrine</u>. The *MCI* four-part test may be anachronistic in light of later Supreme Court decisions like *Aspen* and *Verizon*, which look to both anticompetitive effects and justifications. The Supreme Court certainly seemed skeptical in *Verizon* that "essential facilities" provides anything useful to the analysis of refusals to deal under Section 2.

(ii) <u>Cheap talk</u>. How to deal with conduct that costs or risks little to the actor but may produce great benefits for it owing to the conduct's tendency to exclude rivals? There may be conduct that is costless to the defendant and tends to exclude rivals, as in *Unocal (In the matter of Union Oil Co. of Calif.*, FTC Dkt. No. 9305 (still pending before the FTC)) and *Allied Tube & Conduit Corp. v. Indian Head, Inc.***,** 486 U.S. 492 (1988), but involves no discernable efficiencies. The profit sacrifice and but for standards may not capture this conduct.

(iii) <u>Safe harbors for beneficial conduct</u>. Should certain types of potentially exclusionary -- but likely beneficial -- conduct be placed in a prudential safe harbor? For example: (a) Improved product quality, successful R&D, cost-reducing innovations, and the introduction of a new product may be so likely to enhance consumer welfare as to be considered "competition on the merits" and deemed not to violate Section 2, without attempting to identify the exceedingly rare case that would be an exception to this general rule. (b) While perhaps not as clearly established in the case law, the refusal to license intellectual property rights might also be found to violate Section 2 only in exceptional circumstances. At this point, there does not appear to be a clear consensus in favor of establishing safe harbors.

(1) Some argue that firms with significant market shares already enjoy a safe harbor to the extent that they do not hold market shares in excess of levels generally recognized by courts as sufficient to presume monopoly power, i.e., greater than 70 percent. Unilateral conduct by firms with shares smaller than these relatively high thresholds – especially when contrasted with the concept of "dominance," which prevails in the EU and many other jurisdictions, would generally fall outside the scope of Section 2.

(2) Others contend that the uncertainty of market definition analysis may place firms with much lower market shares at risk of incurring Section 2 liability, thus creating difficulty for antitrust counselors seeking to guide business decisionmakers. Increased reliance on direct evidence of the actual exercise of monopoly power in lieu of market share evidence may also increase uncertainty.

10. What calls for AMC considering the standard?

a. There is no single standard for defining exclusionary conduct beyond *Aspen's* definition of "competition on some basis other than efficiency," which was drawn from the work of Bork and Areeda. A single, clear standard might serve to inform market participants when they would violate Section 2, if it in fact was readily applicable to the wide range of conduct by monopolists that can negatively impact competition. It is not clear, however, whether it is possible to have a single standard that is not facially broad in terms and in need of fact-specific common law rules to make its application clear to different kinds of conduct. This is the situation we have today. What standard could apply to facts as varied as those in *Aspen, Kodak, Trinko, Microsoft, U.S. Tobacco, LePage's,* and *Dentsply*? Is there anything all that inconsistent about the results in these cases that suggests confusion in the application of the general standard?

b. Are the various standards, as applied, leading to undesirable results, such as unnecessary punishment of business, deterrence of procompetitive conduct, failure to protect consumers, or monopolization? (Can we answer this question?)

11. The emergence of differing "dominant firm" standards in other jurisdictions may be having an impact on the business conduct of firms that do business in multiple jurisdictions. Does this suggest a need for change in the standards applicable under Section 2?

a. Some foreign jurisdictions have adopted or are planning to adopt Abuse of Dominance Guidelines.

b. The concept of "dominance" is often triggered at much lower market share thresholds than U.S. monopolization standards.

c. Similarly, the concept of "abuse" may be more inclusive than the "exclusionary/predatory conduct" standard under Section 2. The continuing evolution of varying international standards of conduct may merit further empirical study.

12. The issue posed appears to be whether continued reliance on the evolution of common law is sufficient to strike an appropriate balance over the long term.

a. It does not appear possible to predict that any single standard for Section 2 liability would achieve a better result than the existing common law approach of achieving the dual public purposes articulated by the Supreme Court, i.e., to allow successful competitors to reap the rewards of a legitimate monopoly while ensuring that conduct by a monopolist does not significantly harm the competitive system on which we rely to protect consumer welfare.

b. In light of the difficulty of the questions posed by the choice of an appropriate standard, there appears to be little reason to explore statutory change.

c. In lieu of changing the statute or recommending adoption of a single standard for exclusionary conduct, some have suggested that it might be appropriate to detreble damages for some or all violations of Section 2. The objective would be to reduce the incentives, if any, to bring non-meritorious Section 2 claims. A variation of detrebling would be to provide flexibility for the court to assess damages up to and including treble damages based on the level of consumer harm associated with specific exclusionary conduct and the extent to which a remedy is needed to deter such conduct in the future. Others observe that detrebling might significantly reduce the enforcement value of Section 2 and that, since Section 2 cases are rarely brought and even more rarely won by plaintiffs, detrebling is unnecessary.

D. REFUSALS TO DEAL

1. What are the circumstances in which a firm's refusal to deal with (or discrimination against) rivals in adjacent markets violates Section 2? What are the circumstances in which a firm's refusal to deal with (or discriminate against) a customer or supplier violates Section 2? Does the Supreme Court's decision in *Trinko* state an appropriate, generally applicable standard?

a. An alternative articulation of the issue would be: "Under what circumstances, if any, should Section 2 impose a duty to deal on a monopolist or would-be monopolist?" Duties to deal typically arise as remedies for refusals to deal, but may also arise as remedies for other kinds of exclusionary conduct. Hence, monopolist's dealings with rivals can be approached as: (a) a question of violation ("refusal to deal") ; (b) as a remedy to the refusal to deal violation, or (c) as a remedy for other misconduct where necessary to restore competitive conditions disrupted by the monopolist's challenged conduct. Under U.S. law, sharing is not a remedy without some violation, and refusal to share without more may not be a violation, even in the essential facilities context, under *Aspen* and *Trinko*. There may be some other violation that would call for sharing as a remedy, but it would be the rare case, based on specific facts (e.g., Microsoft Europe).

2. Policy Issue

   a. Finding the right refusal to deal standard is difficult for the same reasons as finding the right definition of exclusionary conduct. An aggressive standard may help to undercut monopolies, but also may undercut incentives to compete, and procompetitive and anticompetitive conduct often looks alike.

3. Impact of *Trinko*

   a. *Trinko* does not state an all-purpose test for what refusals to deal violate Section 2. Specifically, it doesn't address refusals to deal absent government regulation of competition or refusals to deal with non-rivals, such as customers or suppliers. It is also subject to varying interpretations.

   b. *Trinko* states that the general rule is that a refusal to cooperate with rivals is not exclusionary conduct and without more does not violate Section 2. The Court then examines the circumstances in which exceptions might be found, making clear that these exceptions are rare. The Court acknowledges one exception it had recognized in the past, *Aspen*, where a previous course of dealing existed, indicating that it is at or near the outer limit of Section 2. It also throws into question the future viability of the essential facilities doctrine. The Court indicates that the presence of regulation makes the expansion of antitrust liability (viz., whether an exception should be created) less necessary and less desirable. Finally, the Court makes clear that monopoly leveraging is not a distinct offense and that Section 2 should not be used for de-monopolization. *Trinko* might also be read to say that absent a prior course of dealing, a refusal to deal cannot itself constitute a violation of Section 2.

   c. *Trinko* certainly does not announce a new Section 2 standard, and the Court did not explicitly mention or endorse the Government's recommended standard. But the Court's analysis arguably focuses on the same facts that suggest a violation under the "no economic sense" standard like that the Government proposed. Distinguishing *Aspen*, the Court focused on certain facts, including whether the defendant forewent short term profits because it would profit in the long term after competition exited. From this and the fact Verizon won, some have argued that the Court implicitly endorsed the "no economic sense" standard:

(i) Test as stated in government brief: "[C]onduct is not exclusionary or predatory *unless* it would make no economic sense for the defendant but for its tendency to eliminate or lessen competition." *See* Brief of the United States and the Federal Trade Commission as Amici Curiae Supporting Petitioner, at 15.

(ii) But government brief on the merits was clear that this test would apply only in cases involving an alleged duty to assist a rival. *Id.* The more general test advocated was the disproportionality test: “[T]he harm to competition must be disproportionate to consumer benefits…and to the economic benefits to the defendant….” *Id.* at 14.

4. Conclusion

a. In the absence of consensus and in light of the trend in the courts to use the doctrine sparingly, our recommendation is that it is unnecessary for the AMC to take action regarding refusals to deal.

E. ESSENTIAL FACILITIES DOCTRINE

1. Historical Background: The essential facilities doctrine has never been expressly endorsed by the U.S. Supreme Court, but it has been applied variously by lower courts over a long period of time and appears to have had an important influence on regulation of dominant firm conduct in the European Union. Relatively few cases, however, have actually imposed liability under this doctrine.

a. *United States v. Terminal Railroad Ass’n*, 224 U.S. 383 (1912); *Associated Press v. United States*, 326 U.S. 1 (1945): Both cases involved concerted action among competitors to deny access to a jointly owned “facility.” Neither case expressly referenced the essential facilities doctrine.

b. *Lorain Journal Co. v. United States,* 342 U.S. 143 (1951). Court approved an order requiring a newspaper to accept advertisements, thus ending the newspaper’s efforts to discourage businesses from advertising with a local radio station.

c. *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973): Court upheld liability of wholesale power supplier that denied power to power systems that competed with it on the retail level. Case did not expressly reference essential facilities doctrine, but has been cited by lower courts as endorsing this doctrine.

d. The Seventh Circuit fashioned an influential test to be satisfied before a court can determine that a facility or asset is "essential" and, therefore, the monopolist controlling it might be subject to a duty to share. *MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1132–33 (7th Cir. 1983): AT&T held liable for refusing to interconnect with MCI because such interconnection was essential for MCI to be able to compete in the long distance business.

> *MCI* Test: "(1) control of the essential facility by a monopolist; (2) a competitor's inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility." *MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1132–33 (7th Cir. 1983).

e. Courts have applied the doctrine to require access on reasonable terms to a wide variety of "bottleneck" assets. *See, e.g., Fishman v. Estate of Wirtz,* 807 F.2d 520 (7th Cir. 1986); *Hecht v. Pro-Football, Inc.*, 570 F.2d 982 (D.C. Cir. 1977); *CTC Communications Corp., v. Bell Atl. Corp.* 77 F. Supp. 2d 124 (D. Me. 1999); *Intergraph Corp. v. Intel Corp.,* 195 F.3d 1346 (Fed. Cir. 1999); *City of Anaheim v. S. Cal. Edison*, 955 F.2d 1373(9th Cir. 1992).

f. Other courts have read the *MCI* test narrowly, noting that it defines limited conditions under which facilities should be viewed as "essential" and serve as the basis for a finding of Section 2 liability. Such conditions may include (1) a refusal to grant access to a facility or asset that cannot be duplicated feasibly; (2) evidence that the refusal totally eliminated competition, not merely impaired it; and (3) that the defendant actually possessed the power to exclude competition in a downstream market and did so. *See, e.g.*, *Alaska Airlines, Inc. v. United Airlines, Inc*., 948 F.2d 536 (9th Cir. 1991). *See also Olympia Leasing v. Western Union Telegraph Co*., 797 F.2d 370 (7th Cir. 1986).

g. European Commission: "A company which has a dominant position in the provision of facilities which are essential for the supply of goods or services abuses its dominant position where, without objective justification, it refuses access to those facilities." Case COMP D3/38.044 — NDC Health/IMS Health. *See* Sebastien J. Evrad, *Essential Facilities* *in the European Union: Bronner and Beyond*, 10 Colum. J. Eur. L. 491 (2004).

2. Issues raised by the Essential Facilities Doctrine:

   a. A fundamental tension exists between the doctrine's implications, i.e., that there are circumstances in which a monopolist has a duty to share its facilities or assets with competitors, and the generally-accepted principle of antitrust law that firms have wide discretion not to deal with or to assist competitors. *But see United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919).

   b. *Trinko* cast doubt on the doctrine's viability by indicating that prior Supreme Court cases "never recognized such a doctrine." *Trinko* at 411. The Court nevertheless expressly refused either to "recognize it or repudiate it," opining instead that essential facilities claims should be denied "where a state or federal agency has effective power to compel sharing and to regulate its scope and terms." *Id.*

   c. Academic commentators suggest that the doctrine is necessary in limited circumstances to ensure competition in a market where multiple firms could compete but are prevented from doing so because of a refusal of access to an essential asset or facility.

   d. Commentators supporting its use note that, because the doctrine is an exception to the general rule that a monopolist may choose with whom to deal, courts have limited the circumstances under which access to a facility or asset will be ordered. In its limited form, the doctrine may provide a valuable tool for protecting competition and prove to be superior to regulation by government agencies, which may not always be agile and can be subject to capture by the regulated. *See, e.g.*,

      (i) Abbot B. Lipsky & J. Gregory Sidak, *Symposium, Tribute to William F. Baxter, Essential Facilities*, 51 Stan. L. Rev. 1187 (1999).

      (ii) Paul D. Marquardt & Mark Leddy, *The Essential Facilities Doctrine and Intellectual Property Rights: A Response to Pitofsky, Patterson, and Hooks,* 70 Antitrust L.J. 847 (2003).

      (iii) Robert Pitofsky, Donna Patterson & Jonathan Hooks, *The Essential Facilities Doctrine Under U.S. Antitrust Law,* 70 Antitrust L.J. 443 (2002).

   e. Scholars have criticized the doctrine on a variety of grounds:

(i) mandatory sharing obligations may deter investment and innovation;

(ii) the doctrine's unfettered application to intellectual property could penalize successful innovators;

(iii) the doctrine puts courts into the ill-suited role of public utility regulators;

(iv) the doctrine provides unsuccessful competitors with an inappropriate tool for free-riding on the success of rivals; and

(v) the doctrine requires regulated terms of access which are unlikely to result in efficient pricing.

f. Critics suggest that the anticompetitive concerns to which the doctrine is addressed can be effectively handled through application of precedents applicable to refusals to deal without risking its asserted negative consequences. *See, e.g.,*:

(i) Allen Kezsbom, Alan V. Goldman, *No Shortcut to Antitrust Analysis: The Twisted Journey of the 'Essential Facilities' Doctrine,* Columbia Bus. L. Rev. 1996.

(ii) HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY 305 (3d ed. 2005).

(iii) John Thorne, *A Categorical Rule Limiting Section 2 of the Sherman Act:* Verizon v. Trinko, 72 U. Chi. L. Rev. 289, 300 (2005).

(iv) Michael Boudin, *Antitrust Doctrine and the Sway of Metaphor*, 75 Geo. L.J. 395 (1986).

(v) Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 Antitrust L.J. 841, 841 (1990).

g. Although some advocate repudiation of the doctrine, there appears to be consensus that the conduct to which it has been applied was appropriately the subject of Section 2 liability. There does not appear to be consensus on how the law would treat denial of access and related claims in the absence of an essential facilities doctrine.

3. <u>Essential Facilities Doctrine Reform</u>: There are a range of potential modifications to the essential facilities doctrine—from abolition to clarification, to invigoration.

a. Abolish the doctrine and replace it with principles to be applied in cases where denial of access to facilities or assets creates competitive concerns.

b. Limit the doctrine to cases involving concerted conduct such as in *Terminal Railroad* and *Associated Press.*

c. Confirm the viability of the doctrine, specify limitations on its use to avoid over-deterrence and endorse a particular test—along the lines of the *MCI* test.

(i) Restrict the use of the doctrine in cases involving mandatory licensing of intellectual property.

4. If the doctrine is maintained, clarify the standards for determining whether a monopolist's denial of access to an essential facility is lawful. Tests could include:

a. <u>Subjective Test</u>: Is the intent of the monopolist to harm competition/injure a competitor?

(i) This has been criticized: "The defendant's intention is seldom illuminating, because every firm that denies its facilities to rivals does so to limit competition with itself and increase its profits." Areeda, *supra*, at 852.

b. <u>Objective Test</u>: Does the decision to deny access only make economic sense if it has the effect of monopolizing a separate market?

c. <u>Alternative</u>: "The basic principle is that if a reasonable owner of the facility who had no interest in any downstream operation would have a substantial interest, acting rationally, to refuse access, the owner is entitled to do so." Temple Lang, *The Principle of Essential Facilities in European Community Law—The Position since Bronner*, 1 J. Network Indus. 375, 385 (2000).

5. Loosen the requirements for an essential facilities claim, by, for example:

a. Permitting claims in cases where government has the ability to order access, but has elected not to exercise this ability (i.e., reverse that aspect of *Trinko*);

b. Adopting a more pragmatic and flexible definition of "essential"—which would only require a showing that the facility is competitively important.

<u>Conclusion</u>: Because the essential facilities doctrine raises some substantial concern of over-deterrence, many commentators have called for its abolition. In the view of these commentators, the doctrine could be abolished without undermining appropriate enforcement of anticompetitive denials of access that harm consumer welfare. However, other commentators are concerned that anticompetitive unilateral denials of access do not appear to be adequately addressed under other refusal to deal precedents, thus they argue

that abolition of the doctrine even in its current limited form would be harmful, albeit in a limited number of cases. Their conclusion is reinforced by the observed tendency for courts to impose limits on the doctrine. Although there is no clear consensus for abolition or retention of the doctrine, courts have progressively narrowed the application of the doctrine to avoid over-deterrence, while still considering its application in very limited circumstances. In the absence of consensus and in light of the trend in the courts to use the doctrine sparingly, our recommendation is that it is unnecessary for the AMC to take action in this area.

F. PRODUCT BUNDLING AND BUNDLED PRICING

1. The AMC has invited comments on the limited controversy spawned by cases like *LePage's* with respect to the appropriate legal standard for judging product bundling and bundled pricing when practiced by dominant firms. It has not invited a full review of exclusive dealing, tying, or other sorts of distribution strategies that may constitute exclusionary conduct.

    a. Although product bundling may have some relationship to traditional tying doctrine, it has not been subjected to the *per se* rule of *Jefferson Parish*, and neither has bundled pricing.

    b. A thorough review of tying doctrine, therefore, is beyond the scope of this position paper. We note, however, that the Supreme Court's decision to grant a writ of certiorari in *Independent Ink*, which presents the issue whether market power should be presumed in the tying context when the tying product is patented, may provide an occasion for the Court to express its views about the continued vitality of the *per se* rule against tying generally.

2. Bundled pricing of the kind at issue in *LePage's* is probably a ubiquitous practice. Commentators differ in their views of whether and under what circumstances it may pose significant competitive concerns, but to the extent it does, it is likely to do so only in limited circumstances.

    a. There have been relatively few reported cases of challenges to bundled pricing, and these cases have reached varying conclusions. Those cases include:

        SmithKline v. Eli Lilly, 575 F.2d 1056 (3d Cir. 1978); *Ortho Diagnostic Sys., Inc. v. Abbott Labs, Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996); and *LePage's Inc. v. 3M Company*, 324 F.3d 141 (3d Cir. 2003), cert. denied, 124 S.Ct. 2932 (2004).

        See also Michelin v. EC Commission, Case T-203/01, Sept. 30, 2003 (Ct. First Instance) ("*Michelin II*").

b. Other forms of pricing by dominant firms have also been scrutinized by the courts, such as various kinds of incentive payments, rebates, loyalty and market share discounts. Some other related cases include:

Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039 (8th Cir. 2000), cert. denied, 531 U.S. 979 (2000) (market share discounts).

J.B.D.L. Corp. v. Wyeth-Ayerst Laboratories, Inc., 2005 WL 1396940 (S.D.Ohio Jun 13, 2005) (challenging various rebate and formulary contracts for prescription pharmaceuticals and refusing to follow *LePage's*).

3. DOJ/FTC Amicus in *LePage's*

a. Third Circuit's decision is open to criticism on a number of grounds.

b. It has been openly questioned by at least one district court in *J.B.D.L*, which is currently on appeal.

c. 3M and some commentators argued that it is inappropriate in cases of bundled pricing to rely as the Third Circuit did on *Aspen* and *Kodak*. Instead, it should be analyzed under *Brooke Group* and *Matsushita* as a species of predatory pricing and be unlawful only (1) when below some measure of cost, and (2) in a context where recoupment is likely. Otherwise, it is argued, pro-competitive strategies that result in lower prices will be over-deterred.

d. Commentators also urge action because *LePage's* has led to significant uncertainty as to the legality of pricing strategies by dominant firms, which increases compliance costs and may inhibit pro-competitive price-lowering strategies.

e. But DOJ argued to the Supreme Court that it would be premature for the Court to take the case. The law and economics of bundled pricing is not yet fully developed and requires further study both by courts and economists. The government argued that bundled rebates are distinguishable from predatory pricing, and hence should not be evaluated, as 3M urged, under the elevated standards of *Brooke Group*, which have been justified by fears of false positives and loss of immediate consumer benefits. Indeed, it argued, although "bundled rebates are widespread and are likely, in many cases, to be pro-competitive. . .the bundling of rebates (as distinct from the price reductions that may result) is not necessarily procompetitive." The brief continued:

> Unlike a low but above-cost price on a single product, a bundled rebate or discount can – under certain theoretical assumptions – exclude an equally efficient competitor, if

> the competitor competes with respect to but one component of the bundle and cannot profitably match the discount aggregated over the other products, even if the post-discount prices for both the bundle as a whole and each of its components are above cost.

f. Although a clear test would be welcome, it is not clear yet what that test should be and what empirical basis exists for endorsing any particular test, including the predatory pricing standard of *Matsushita-Brooke Group*.

4. The legal and economic issues relating to bundled pricing are complex and have led to a somewhat unsettled area of antitrust law.

a. Standards for Price Predation vs. Non-price Exclusionary Conduct (*Matsushita-Brooke Group* vs. *Aspen-Kodak-Verizon*) can lead to very different results when applied to price-related behavior such as bundled rebates.

b. As noted above, 3M and some advocates and commentators have urged the courts to evaluate all pricing strategies by dominant firms under the predatory pricing standards of *Matsushita-Brooke Group,* whereas others have argued that predatory pricing is economically distinct from bundled pricing and other forms of pricing strategies.

c. In *LePage's*, the Third Circuit rejected reliance on the predatory pricing standard, pointing to such factors as: the effects of 3M's bundled pricing on LePage's, which did not produce an equally diverse set of products; entry barriers; the degree to which 3M's discounts impaired LePage's ability to maintain minimal scale economies; the likelihood that 3M would recoup its discounts through the later exercise of its monopoly power by raising prices after LePage's was eliminated; its intent to do just that in adopting the bundled discounts; the degree to which the discounts 3M offered to its customers greatly exceeded any savings it may have realized from bundling; and 3M's lack of evidence of any other valid business reasons for its conduct.

d. In *Ortho Diagnostic*, the district court proposed the following test for evaluating bundled rebates:

> "[A] Section 2 plaintiff in a case like this-a case in which a monopolist (1) faces competition on only part of a complementary group of products, (2) offers the products both as a package and individually, and (3) effectively forces its competitors to absorb the differential between the bundled and unbundled prices of the product in which the

> monopolist has market power-must allege and prove either that (a) the monopolist has priced below its average variable cost or (b) the plaintiff is at least as efficient a producer of the competitive product as the defendant, but that the defendant's pricing makes it unprofitable for the plaintiff to continue to produce."

e. In lieu of a tailored standard, the various incentive, rebate, and discount cases in the courts have undertaken a case-by-case, fact specific, economic analysis of various examples of allegedly exclusionary pricing strategies by dominant firms, looking to their effects and economic justifications.

5. Academic study continues, but critical questions remain unanswered. A great deal of commentary has been generated in response to LePage's:

a. Crane, Daniel A, *Multiproduct Discounting: A Myth of Non-Price Predation*, 72 U. Chi. L. Rev. 27 (2005) (Part of Symposium)

b. Davis, Ronald W., *Pricing with Strings Attached: At Sea in* Concord Boat *and* LePage's, 14-SUM Antitrust 69 (2000)

c. Edlin, Aaron S. & Rubinfeld, Daniel L, *Exclusion or Efficient Pricing? The "Big Deal" Bundling of Academic Journals*, 72 Antitrust L.J. 119 (2004)

d. Epstein, Richard A., *Monopoly Dominance or Level Playing Field?: The New Antitrust Paradox*, 72 U. Chi. L. Rev. 49 (2005) (Part of Symposium)

e. Greenlee, Patrick, Reitman, David, & Sibley, David S., *An Antitrust Analysis of Bundled Loyalty Discounts* (unpublished paper 2004) (abstract available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=600799).

f. Greenlee, Patrick & Reitman, David, *Competing with Loyalty Discounts* (unpublished working paper 2005) (abstract available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=502303)

g. Lambert, Thomas, A., *Evaluating Bundled Discounts*, 89 Minn. L. Rev. 1688 (2005)

h. Nalebuff, Barry, *Bundling as a Barrier to Entry*, 119 Q. J. of Econs. 159 (2004) [Note: Nalebuff has done extensive work in the field and has several other published and unpublished papers evaluating various aspects of bundling).

i. Posner, Richard A., *Vertical Restraints and Antitrust Policy*, 72 U. Chi. L. Rev. 229 (2005) (Part of Symposium)

j. Rubinfeld, Daniel L., *3M's Bundled Rebates: An Economic Perspective*, 72 U. Chi. L. Rev. 243 (2005) (Part of Symposium)

k. Ramirez, Roberto, Note, *Predatory Pricing and Bundled Rebates: The Ramifications of LePage's Inc. v. 3M for Consumers*, 17 Wash. U. J.L. & Pol'y 259 (2005)

l. Warren, Joanna, Comment, *LePage's v. 3M: An Antirust Analysis of Loyalty Rebates*, 79 N.Y.U. L. Rev. 1605 (2004)

6. Commentators have yet to reach a consensus, however, in response to the call for further study expressed by the government in its brief in *LePage's*, as to the economic consequences of bundling.

   See Kobayashi, Bruce H., Bundling: *A Survey of the Economic Literature* (2005) (working draft; available from author – collecting and surveying economic literature on bundling and concluding that "a review of the economic literature supports the SG's position [in *LePage's*] with respect to delaying the promulgation of antitrust standards for bundling.")

7. There is little doubt that a great deal of uncertainty has been spawned by *LePage's*, and there are always costs associated with such uncertainty. It complicates and increases the cost of antitrust counseling, complicates the task of risk assessment by firms evaluating pricing strategies, and may even inhibit some firms that are dominant from undertaking certain kinds of aggressive pricing strategies.

   a. Advocating a conduct-specific standard, especially if attempted through legislation, would be contrary to the long-standing common law history of the Sherman Act, including Section 2.

   b. Even if the AMC concludes that the statement of a standard to clarify the area would be helpful, it is not at all clear what that standard should be, and there is currently no basis for adopting any particular standard for judging bundled pricing.

   c. The AMC should permit the issue to continue to develop in the literature and the Courts.

Discussion Paper appears to acknowledge that harm to customers through actions by a supplier of aftermarket products and services is a limited concern. The only example provided is one in which a supplier adopts a "policy change" with respect to aftermarket products or services. *See* ¶¶ 261-62. However, such a change is likely to take place only in very unusual circumstances—where both (1) the entire primary market is declining or the particular supplier has decided to exit or is losing market share and (2) the relevant supplier is not engaged in other equipment markets and thus would not be deterred by the impact of the "policy change" on its reputation. *See* ¶ 262. Even in those very limited situations, there would be no harm to customers if the customers utilized the primary market competition to protect themselves by contract when they purchased the equipment. *See* ¶ 263. The Sections submit that it is preferable to address this limited concern regarding "installed based opportunism" through private contracts rather than by attempting to apply Article 82 to single-brand aftermarkets and treating a "policy change" as a potential abuse of dominance.[76] Otherwise, there is a risk that suppliers will be deterred from adopting more open and flexible aftermarket policies in the first place if future changes in those policies will subject them to a risk of costly investigations, fines, and private damage actions for violation of Article 82.[77]

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market" the "less likely it is that the supplier in question can be considered dominant on the aftermarket" for its brand of equipment ¶ 260), in fact the analysis in the Discussion Paper leaves such suppliers exposed to a finding of dominance and of abuse of dominance if they "decide to change policy and raise prices in the aftermarket or restrict the possibilities of other suppliers in the aftermarket." ¶ 261). In sum once such a supplier has begun to deal with others in connection with the aftermarket for its brand of equipment, the analysis in the Discussion Paper indicates that any attempt to "change policy" will expose the supplier to Article 82 claims.

[76] *See* Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal—Why* Aspen *and* Kodak *Are Misguided*, 69 ANTITRUST L.J. 659, 679-680 & n.39 (2001); Benjamin Klein, *Market Power in Antitrust: Economic Analysis After* Kodak, 3 SUP. CT. ECON. REV. 43, 47-63 (1993).

[77] For example, a supplier might be willing to supply parts to third-party service firms or to train their personnel in order to make its primary products more attractive to customers because of the presence of a number of service alternatives, including alternatives located close to potential customers. Such an approach might assist a small supplier in entering the primary market or in expanding its sales in the primary market. However, if taking such an approach to aftermarket parts and training could not be altered in the future without violating Article 82, it is possible that the supplier would be deterred from pursuing that approach. The concern that efficient conduct that benefits consumers will be deterred by an analysis that places importance on "policy changes" is similar to the problem noted with the different standards set forth in the Discussion Paper for "termination of an existing supply relationship" and "refusal to start to supply". See section 6 of these comments.