HUNTON & WILLIAMS

REFUSALS TO DEAL AND ESSENTIAL FACILITIES

TESTIMONY OF R. HEWITT PATE

SUBMITTED ON BEHALF OF THE
UNITED STATES TELECOM ASSOCIATION

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I. **Background**

My name is R. Hewitt Pate. I am a partner at the law firm of Hunton & Williams LLP, where I head the firm's competition practice. From 2001 to 2005, I served in the U.S. Department of Justice as Assistant Attorney General and earlier as Deputy Assistant Attorney General for regulatory matters. I am appearing today on behalf of the United States Telecom Association, but the opinions I express today are my own, and it will be evident to you that they are consistent with the public policy I advocated while in government service.

The general point of this testimony is that independent competition among competitors who do not rely upon one another for assistance -- or even for pulled punches in the competitive process -- is what best produces innovative products and services at the lowest price. Government imposed duties to assist competitors force courts into price regulation for which they are ill-equipped. Particularly in capital intensive or high technology fields, the uncertainty caused by intrusive liability rules will retard desirable investment. The U.S. system of private litigation exacerbates the problem. Recent experience with the telecommunications field provides an excellent illustration of this point.

Forced sharing is especially damaging in industries requiring high cost, high risk infrastructure investments, such as telecommunications. Expenditures of this type are made only when a company can reasonably expect a return on its investment. This in turn requires that the legal and regulatory environment be predictable, and not unduly limit the return on investment. This testimony focuses on these factors -- certainty and threats to investment -- as they relate to Section 2 of the Sherman Act.

This testimony first addresses refusals to deal and essential facilities. As *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), illustrates, the telecommunications industry has a great deal of experience with these doctrines. This testimony explains the state of the law after *Trinko*, and recommends where these doctrines should go in the future, which is not much of anywhere. These doctrines inherently generate uncertainty and threaten returns on investment, thus discouraging investment in the first place.

Specifically, with respect to refusals to deal, at this point the time has come for *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), to be overruled. Some commentators now suggest that what is left of *Aspen Skiing* means that antitrust claims involving refusals to deal remain viable where there is a preexisting relationship. A preexisting relationship did distinguish *Aspen* from *Trinko*, but it is a faulty hook for Section 2 liability. With respect to essential facilities, the concept has never been embraced by the Supreme Court, and continues to exist only at the fringes of Section 2. The agencies and courts should explicitly reject “essential facilities” as a Section 2 theory of liability.

The second point of this testimony is to urge the agencies to continue pushing for more objective standards to determine what acts will be considered “anticompetitive” under Section 2. Telecommunications companies -- as well as many other businesses -- presently lack any practical guidance to determine *ex ante* whether their actions are anticompetitive. Uncertainty imposes a tax -- often a prohibitive one -- on investment and other procompetitive behavior. It is no answer to say that large firms can avoid trouble by forgoing actions their competitors might see as “unfair.” Antitrust policy cannot be coherent if ever-increasing penalties tell firms to avoid collusion, while at the same time Section 2 litigation tells them to embrace broad obligations to assist their competitors.

II. The Telecommunications Industry and Forced Sharing

The telecommunications industry is one where huge capital expenditures and great risk must be undertaken before profits can be made.[1] Forced sharing -- or even the potential for forced sharing -- imposes dangerous disincentives to this type of investment. This is particularly so given the rapid technological change that characterizes the industry. Although forced sharing can have dangerous effects in even stable, mature industries, it has much more pernicious effects where it can chill investment in the next disruptive technology (or drive investment to foreign firms not subject to the same obligations).

One of my responsibilities at DOJ was to work on the DOJ's part in the implementation of the Telecommunications Act of 1996, which had at its heart forced sharing or "unbundling" obligations. In my experience, DOJ staff worked extremely hard to perform their duties under the Act. My experience with this process, however, left me convinced that forced sharing of assets with competitors is not a sound foundation for promoting competition.

Unbundling obligations in the 1996 Act required Incumbent Local Exchange Carriers (ILECs) to share network elements with Competitive Local Exchange Carriers (CLECs) at wholesale rates. The unbundling obligations in the Act were based on a "stepping stone theory." That is, granting CLECs access to ILECs' facilities at wholesale rates would allow CLECs to enter the market initially without building facilities. This would bring immediate competition to the market and, importantly, prompt CLECs to develop their own facilities to compete with ILECs. Facilities-based competition would continue thereafter.

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[1] One report estimates that the capital expenditures made by the four largest ILECs amounted to nearly 3 percent of all such corporate expenditures in the United States from 1996 to 2002. *See* James Gattuso and Norbert Michel, *Are U.S. Telecom Networks Public Property?* (April 8, 2004), *available at* http://www.heritage.org/Research/InternetandTechnology/bg1745.cfm.

At this point, some basic lessons are difficult to deny. Rather than provide a stepping stone to independent competition, sharing obligations led to demands for ever greater and more complicated sharing obligations, many of which were found unlawful by the courts. One recent writer who is generally supportive of forced sharing summed it up this way: "[T]he 1996 Act is, arguably, a good example of the questionable effectiveness of a legally mandated sharing. After eight years, the FCC has failed to produce a legal system of access and has instead furthered a disastrous $50 billion telecom boom and bust in local telecommunications."[2]

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[2] Adam Candeub, *Trinko and Re-grounding the Refusal to Deal Doctrine*, 66 U. Pitt. L. Rev. 821, 833 (2005). For a discussion of how the FCC's implementation of the Act simply created artificial or synthetic competition and had negative incentive effects on ILEC and CLEC investment, see George Bittlingmayer & Thomas W. Hazlett, *The Financial Effects of Broadband Regulation*, in Robert W. Crandall & James H. Alleman, eds., *Broadband* 245, 252-54 (2002) (hereinafter "*Broadband*"); Robert W. Crandall & Martin W. Hazlett, *Telecommunications Policy Reform in the U.S. and Canada*, in *Telecommunications Liberalization on Two Sides of the Atlantic* 8, 22-23 (Martin Cave & Robert W. Crandall, eds., 2001); Jerry A. Hausman & J. Gregory Sidak, *A Consumer-Welfare Approach to Mandatory Unbundling of Telecommunications Networks*, 109 Yale L.J. 417, 458 (1999) ("Disincentive effects on incumbents are substantial, particularly because those firms must continue to make large investments in their existing networks…. Consumers also suffer from the effect of unbundling on the incentives of entrants."); Jerry Hausman, *Internet-Related Services: The Results of Asymmetric Regulation*, in *Broadband* 129, 136-39, 148-49, 151; Thomas W. Hazlett, *Rivalrous Telecommunications Networks With and Without Mandatory Sharing*, 58 Fed. Communications L.J. 478 (2006) (discussing empirical evidence); Herbert Hovenkamp, *The Antitrust Enterprise* 245-46 (2005); Herbert Hovenkamp, *Antitrust and the Regulatory Enterprise*, 2004 Colum. Bus. L. Rev. 335, 370 ("Indeed, one of the ironies of the 1996 Telecommunications Act is that it may actually have retarded the development of a competitive infrastructure for local telephony because it permits CLECs simply to lease everything they want at steeply discounted prices, rather than forcing them to build for themselves where they could reasonably do so."); Peter Huber, *Telecom undone - a cautionary tale*, Commentary (January 2003) (explaining that CLECs built networks "out of paper," designed not for long-term competition but to play the regulatory game), *available at* http://www.manhattan-institute.org/html/_comm-telecom.htm; Charles Jackson, *Wired High-Speed Access*, in *Broadband* 83, 100-01; Dale E. Lehman & Dennis Weisman, *The Telecommunications Act of 1996: The "Costs" of Managed Competition* 13, 112-13 (2000); Stephen Pociask, *Telescam: How Telecom Regulators Harm California Consumers*, Pacific Research Institute Policy Briefing (August 2003) (study finding that the Act caused decreases in investment and that the regulatory regime hurt the economy and noting similar studies); Amy Schatz, *Fighting a*

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As the above quote suggests, the FCC, the agency with expertise in the telecom area, has had a notoriously difficult time determining when sharing should be required and under what terms. The indisputable winners from the Act have not been competition or consumers, but lawyers, lobbyists, experts, and others who have profited from fighting over the intractable questions produced by forced sharing.[3] This of course is normally the case when the government takes on the role of central planner.

It also appears clear at this point that the Act's forced sharing obligations have thwarted or slowed investment in key areas. This is most evident with respect to broadband service. AT&T Chairman and CEO Michael Armstrong cautioned in a 1998 speech: "No company will invest billions of dollars to become a facilities-based broadband service provider if competitors who have not invested a penny of capital nor taken an ounce of risk can come along and get a free ride on the investments and risks of others."[4] The cable industry made this disincentive

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Broadband Battle, Wall Street Journal, July 19, 2005, at A4 (quoting FCC Chairman Kevin martin); Howard A. Shelanski, *Competition and Regulation in Broadband Communications*, in *Broadband* 157, 177-85.

[3] *See* J. Gregory Sidak, *The Failure of Good Intentions: The WorldCom Fraud and the Collapse of American Telecommunications After Deregulation*, 20 Yale J. on Reg. 207, 212-13 (2003) (examining the transaction costs associated with the Act; noting the number of pages per year of the FCC Record "nearly tripled in the post-1996 period" and the "number of telecommunications lawyers [in the Federal Communications Bar Association (FCBA)] grew seventy-three percent between December 1994 and December 1998. If one assumes (very conservatively) that the average income of an American telecommunications lawyer is $100,000, then the current membership of the FCBA represents an annual expenditure on legal services of at least $340 million.").

[4] Adam Thierer, *UNE-P and the Future of Telecom "Competition,"* Techknowledge Newsletter (February 1, 2003) (quoting a 1998 speech by Armstrong). *See also Comcast President: Cable TV Industry Would Wither if New Rules Enacted*, TR Daily (Jun 10, 2002) (Brian Roberts, Comcast President, is quoted as saying "even a hint" of regulation "could prove disastrous" to broadband deployment.); Robert Crandall, *The Telecom Act's Phone-y Deregulation*, Wall Street Journal (January 27, 1999) ("Why should these firms invest in new, often risky technology for delivering advanced, high-speed services if they are to be required to
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argument successfully to the FCC and courts, and has not been the subject of similar regulation. But telecom companies, whose DSL service is the next biggest source of broadband competition, were until recently subjected to significant unbundling requirements.

Although there are a few dissenting voices, "[m]ost economists and most studies conclude that unbundling [obligations] in the U.S. reduced incentives to invest in high-speed internet infrastructure."[5] This is consistent with the market realities. Cable companies invested more quickly in their broadband networks than did telephone companies, who were required to share their broadband facilities with competitors. DSL has lagged behind cable in terms of deployment and market share in the United States. This is the opposite of the situation in most countries, where DSL has obtained more market share than cable.[6] It also is notable that, once line sharing regulations were lifted, the number of DSL subscribers began to grow more quickly.[7]

Another telecom-focused example of how forced sharing can affect investment is "fiber-to-the-home" (FTTH) technology, a second-generation broadband technology. FTTH investment and use remained small until 2003 -- the year the FCC decided to ease the unbundling requirements with respect to that technology. In March 2003, there were less than 110,000

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offer any such new facilities to their rivals at cost?"), *available at* http://www.brookings.edu/views/op-ed/crandall/19990127.htm.

[5] Scott Wallsten, *Broadband and Unbundling Regulations in OECD Countries*, AEI-Brookings Joint Center For Regulatory Studies Working Paper 06-16 (June 2006) (collecting studies), *available at* www.aei-brookings.org/admin/authorpdfs/page.php?id=1284.

[6] *See* OECD Broadband Statistics (December 2005), *available at* http://www.oecd.org/document/39/0,2340,en_2649_201185_36459431_1_1_1_1,00.html.

[7] *See, e.g.*, Hazlett, *Rivalrous Telecommunications Networks With and Without Mandatory Sharing*, *supra* note 2, at 481, and other sources cited at *supra* note 2.

homes “passed” with FTTH. By September 2004, that number was up to 970,000, and by January 2006, that number was over 3,500,000.[8]

Similarly, when the FCC announced that it was easing unbundling mandates on “fiber-to-the-curb” technologies, SBC Communications immediately announced that it planned to accelerate its fiber rollout, reaching 18 million U.S. homes in two to three years, rather than five years as previously announced. The cost to deploy the 38,800 miles of fiber was $4 billion to $6 billion.[9]

The telecommunications industry recently has rebounded, not surprisingly in conjunction with a decrease in forced sharing.[10] The calls for reforming the dysfunctional 1996 Act only continue to get louder. Where reform is headed is less than clear. What is clear, however, is that the antitrust community can learn a number of lessons regarding forced sharing from the telecommunications industry’s experience with the 1996 Act.

First, forced sharing discourages and slows innovation. Second, it is difficult -- if not impossible -- even for an expert agency to force competitors to share in a way that promotes

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[8] *See* Testimony of Timothy J. Regan, Senior Vice President for Global Government Affairs, Corning Incorporated, Before the House Energy and Commerce Committee, Subcommittee on Telecommunications and the Internet (March 30, 2006) (citing a study by RVA Research). I do not mean to suggest that removing forced sharing obligations was the *only* reason for this growth.

[9] Grant Gross, *FCC exempts fiber to curb from sharing requirements*, IDG News Service (October 14, 2004), *available at* http://www.networkworld.com/edge/news/2004/1014fccexemp.html?page=2.

[10] *See, e.g.,* Grant Gross, *Study: 2004 was 'turnaround' year for telecom industry*, The Industry Standard (March 17, 2005) (“Growth in the industry has been fueled by decisions at the U.S. Federal Communications Commission relaxing rules that incumbent telephone carriers share parts of their networks with competitors, as well as U.S. President George Bush's push for universal broadband availability by 2007, [said Arthur Gruen of telecom consultancy Wilkofsky Gruen Associates Inc.]”), *available at* http://www.thestandard.com/movabletype/datadigest/archives/003196.php.

competition. The terms of sharing involve so many complex questions and unforeseen consequences that achieving a near-optimal result, measured by encouraging competition and investment, will be extremely difficult. Third, forced sharing, even if possible, carries massive transaction costs that often outweigh any benefit from the sharing. Fourth, forced sharing requires a framework, and that framework often is difficult to change in the face of changed circumstances. The 1996 Act required telecom companies to share DSL infrastructure merely because it came through telephone lines that were historically regulated. That may have been what the statutory terms required, but it made no sense: The Act's sharing obligations were premised on the notion that the telecoms controlled an exclusive "bottleneck" in the relevant transmission facility, a premise that was and is absent when it comes to broadband.[11]

III. **Refusals To Deal And Essential Facilities**

The telecommunications industry also has encountered forced sharing claims in the courts. In the most important recent Section 2 decision, the Supreme Court in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), said the Telecommunications Act of 1996 does not preempt or repeal the antitrust laws. But it held the Act did not create new affirmative "antitrust duties" either; only if the action alleged violates preexisting antitrust standards will a Section 2 claim be viable. The Court then addressed two

[11] *See* Jonathan E. Nuechterlein and Philip J. Weiser, *First Principles for an Effective Rewrite of the Telecommunications Act of 1996*, AEI-Brookings Joint Center Working Paper 05-03, at 13 (March 2005) ("The growth of broadband Internet access, combined with the ubiquity of the TCP/IP protocol suite, has made a mockery of the Communications Act's traditional classifications of different communications services. Nonetheless, because Congress underestimated the pace and extent of technological convergence, those classifications remain embedded in the law. As a result, the industry has become increasingly fixated on lawyers' quarrels about the proper way to 'characterize' particular IP-based services for purposes of classifying each of them within the obsolescent framework of the Communications Act of 1934.").

preexisting antitrust doctrines that are the focus of this panel: refusals to deal and its close relative essential facilities.

A. *Refusals to Deal*

Before *Trinko*, the most prominent refusal to deal case was *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985). In this case, Aspen Ski Co. (Ski Co.) owned three of the four mountains in Aspen, while its competitor Aspen Highlands (Highlands) owned the fourth. The competitors initially offered a joint ski lift ticket, the revenue from which was split pro rata according to how may skiers skied on the respective mountains. Eventually, Ski Co. demanded more of the revenue, but Highlands balked. The two then parted ways.

Highlands' share began to dwindle, while Ski Co.'s increased. Highlands reacted by trying to make it possible for customers to buy a four-mountain ski ticket, but Ski Co. refused to cooperate. Highlands then turned to the courts, claiming Ski Co.'s refusal to deal amounted to a violation of Section 2. The trial court imposed liability, and the Supreme Court affirmed. The Court noted, *inter alia*, that Ski Co. offered no efficiency justification for its actions and forewent short-term gains for long-term monopoly rents, or a jury could have so concluded.[12]

Almost twenty years later, the Section 2 challenge in *Trinko* was based on the claim that Verizon, an ILEC, was not fulfilling affirmative duties imposed by the 1996 Act to help rival CLECs. Specifically, the Complaint alleged that "Verizon had filled rivals' orders [for certain unbundled elements] on a discriminatory basis as part of an anticompetitive scheme to discourage customers from becoming or remaining customers of [CLECs], thus impeding the [CLECs'] ability to enter and compete in the market for local telephone service."[13]

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[12] *Id.* at 610-11.

[13] 540 U.S. at 404.

The Court first rejected the idea that the 1996 Act had preempted antitrust claims by the CLECs. It also rejected the radical notion that the sharing obligations of the 1996 Act had been incorporated into antitrust law, turning antitrust litigation into a second enforcement mechanism for an independent statutory scheme. Instead, the Court held that Section 2 liability must be based on traditional Section 2 duties. The Court then turned to the plaintiffs' refusal to deal claim and rejected it. It did so with resounding clarity, on a motion to dismiss, holding thereby that the claim was so lacking in traditional antitrust merit that it did not even merit discovery.

The Court properly focused on three rationales. First, the Court recognized that compelled sharing has negative incentive effects. "Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities."[14] Second, the Court shared a healthy skepticism of generalist courts' ability to manage sharing: "Enforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing -- a role for which they are ill-suited."[15] Third, the Court recognized the difficulty in distinguishing appropriate from inappropriate liability, *i.e.*, the risk of "false positives," especially in complex fields. The Court said:

> Against the slight benefits of antitrust intervention here, we must weigh a realistic assessment of its costs. Under the best of circumstances, applying the requirements of § 2 "can be difficult" because "the means of illicit exclusion, like the means of legitimate competition, are myriad." *United States v. Microsoft Corp*., 253 F.3d 34, 58 (C.A.D.C. 2001) (en banc) (per curiam). Mistaken inferences and the resulting false condemnations "are especially costly, because they chill the very conduct the antitrust laws are

[14] *Id.* at 407-08.

[15] *Id.* at 408.

> designed to protect." *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986). . . . The cost of false positives counsels against an undue expansion of § 2 liability. Judicial oversight under the Sherman Act [of the complex sharing obligations] would seem destined to distort investment and lead to a new layer of interminable litigation, atop the variety of litigation routes already available to and actively pursued by [CLECs].[16]

The Court chose not to overrule *Aspen*. Instead it cabined the case: "*Aspen* is at or near the outer boundary of § 2 liability, and the present case does not fit within the limited exception it recognized."[17] The Court noted several distinctions between *Aspen* and *Trinko*. First, *Aspen* involved cessation of a voluntary and "presumably profitable" competitor collaboration, whereas Verizon had never voluntarily worked with CLECs. Second, the defendant in *Aspen* turned down its competitor's proposal to sell at its own retail price, whereas Verizon's reluctance to interconnect at a special jump-start below-retail rate was uninformative. Finally, the refusal to deal in *Aspen* involved a "final good" offered to the public, whereas the refusal to deal in *Trinko* involved "intermediate goods," *i.e.*, goods not offered to the public but infrastructure elements that "exist only deep within the bowels of Verizon."[18]

Trinko was a positive development, but did not go far enough with respect to refusals to deal. Perhaps the most positive aspect of *Trinko* was the Court's three rationales, which reflected a healthy humility about government intervention and a long-term view of competition.

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[16] *Id.* at 414.

[17] *Id.* at 409.

[18] *Id.* The plaintiffs also attempted to rely on *United States v. Terminal Railroad Assn. of St. Louis*, 224 U.S. 383 (1912), and *Associated Press v. United States*, 326 U.S. 1 (1945). But as the Court recognized: "These cases involved *concerted* action, which presents greater anticompetitive concerns and is amenable to a remedy that does not require judicial estimation of free-market forces: simply requiring that the outsider be granted nondiscriminatory admission to the club." *Trinko*, 540 U.S. at 410 n. 3 (emphasis in original).

These rationales should guide future courts and agencies in addressing refusal to deal cases. After *Trinko*, the court or agency faced with a refusal to deal case should ask three questions: (1) Will the positive benefits from intervention in this case outweigh any negative effects on incentives to innovate and to invest? (2) Is it possible to devise the terms of sharing and continuously monitor that sharing in a way that reliably makes society better off (including factoring in transaction costs)? (3) Is it clear that what is at issue is anticompetitive conduct, such that there is not a risk that liability is following from hard-nosed competition? If the answer to any of these questions is no, there is no basis to proceed.

A second positive development was the Court carving out intermediate goods from the duty to share. That is, infrastructure elements that are not otherwise offered for sale are immune from a claim of sharing after *Trinko*.[19] This is important to companies, like telecommunications companies, that need to know that Section 2 will not be a tool for free-riding on expensive and risky infrastructure investments that may (or may not) turn out successful. Finally, the Court implicitly reaffirmed that Section 2 does not condemn size alone.[20]

The Court, however, left some important questions open. One is the essential facilities doctrine, discussed below. The second is the meaning of *Aspen.* The Supreme Court, at least most of the time, feels bound by the doctrine of stare decisis, and therefore takes great pains to leave narrow space for decisions that do not comport with modern thinking. Fidelity to prior

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[19] Remarks of Herbert Hovenkamp, Panel Discussion at 5, *Hitting the Section 2 "Refresh" Button for In-House Counsel Following Trinko*, The Antitrust Source (July 2004), *available at* http://www.abanet.org/antitrust/source/July04-Teleconf7=23.pdf (hereinafter "Trinko Roundtable") ("[F]or example, if you're in the business of supplying some input for yourself, if you're a natural gas company and you have built a pipeline only to transport your gas for sale to end users, you're not going to be obligated to share that pipeline unless you're in the general business of renting pipeline space.").

[20] *See United States v. United States Steel Corp.*, 251 U.S. 417, 451 (1920).

case law is generally admirable, but not where it leads to poor doctrinal results. That looks to be the result of the Court preserving *Aspen*.

Taking a cue from some language in *Trinko*, some courts have held and commentators have suggested that an *Aspen*-type claim is still valid so long as there was a prior relationship between the plaintiff and defendant.[21] That was indeed the fact pattern of *Aspen* -- a refusal to deal against the backdrop of a preexisting relationship -- and provided a convenient ground for distinction in *Trinko*. But keying Section 2 liability to a preexisting relationship is not sound policy.

A company can be chilled from efficient conduct just as much if it is forced to share with a competitor with whom it had a preexisting relationship as it would be refusing to share with a competitor in the first place. In those cases in which freely contracting parties have voluntarily agreed to share, the existence of such a prior arrangement may justify an inference that both parties found it economical to share when they entered into the relationship. The preexisting relationship also provides a starting point for defining the often elusive terms of sharing. But the problem is that situations change, and it is inefficient to lock parties into a relationship when the assets subject to the relationship can be put to a higher use. And it is illogical to assume that it is anticompetitive to discontinue a sharing arrangement that has never worked or at least no longer works according to original expectations.

Worse, a doctrine that suggests sharing once entered into must be perpetual could prevent voluntary sharing in the first place. Judge Posner made this point in a telecom context in *Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 797 F.2d 370 (7th Cir. 1986).

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[21] *See, e.g.*, *Covad Communications Co. v. BellSouth Corp.*, 374 F.3d 1044, 1049 (2004); Thomas E. Kauper, *Section Two of the Sherman Act: The Search for Standards*, 93 Geo. L.J. 1623, 1640 (2005).

In that case, Western Union initially aided its competitor Olympia in entering a market, but eventually discontinued that aid when it realized it was detrimental to its own economic goals. The jury imposed Section 2 liability, but the Seventh Circuit overturned the decision. Judge Posner explained: "[I]f Western Union had known that it was undertaking a journey from which there could be no turning back--a journey it could not even interrupt momentarily--it would have been foolish to have embarked. Pertinent therefore is the Supreme Court's recent warning about the possible anticompetitive consequences of allowing a jury to infer monopolization from behavior that in most cases is competitive."[22]

The three concerns that drove *Trinko* may be mitigated when a prior relationship is in the background, but they do not fall away. Forced sharing of any kind will discourage investment and innovation. Courts will still face difficulties in devising the terms of sharing. The terms of the sharing that previously existed may not be useful or even relevant after years of protracted litigation. Also, the difficult question of the duration of the sharing will remain. The danger of "false positives" still will exist as well, especially in terms of courts calculating whether short-term intervention will produce long-term gains.

The danger of the "continued duty to deal" reading of *Aspen* -- and especially its potential to prevent positive collaborations from coming together in the first place -- can be seen in many different areas. In the telecommunications world, a firm might join with a competitor to jointly

[22] *Id.* at 378. For similar criticisms of the "preexisting relationship" view of *Aspen*, see Remarks of Mark Whitener, Trinko Roundtable, *supra* note 19, at 14-15; Einer Elhauge, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. 253, 314 (2003) (criticizing a test that would limit a duty to deal with rivals to "cases where the monopolist terminated an existing willingness to supply rivals" because "such a limitation would create perverse incentives for a monopolist to refrain from ever dealing with a rival . . . out of the fear that this proposed antitrust rule would convert any such dealing into the sort of lifetime tenure normally reserved for professors," and thereby "encourage precisely the sort of discrimination against rivals that is least necessary to further ex ante incentives for investment").

bring an innovative bundle to the market.[23] But if that requires that the firm *always* deal with its competitor, the relationship may never get off the ground.

Consider also intellectual property. "Intellectual property licenses are often exclusive, in whole or in part; locking in relationships in such a context may prevent competition by other potential licensees down the road. Further, as a general matter antitrust law wants to encourage the licensing of intellectual property, since the alternative may be monopoly or at least more centralized control over production. Forcing companies to continue an existing license relationship may have the perverse effect of discouraging them from licensing their intellectual property rights in the first place."[24]

The law would be better off with *Aspen* removed from the books, and the agencies would do the law a service by advocating this in the report from these hearings. As Dennis Carlton has demonstrated, there was no basis for intervention based on economics.[25] Absent the threat of intervention through antitrust, the parties would have continued the joint product (the joint ski lift) if it was superior to proceeding separately. True, Highlands would have gotten less of the total pie. But "[t]here is no reason to regard the sharing of the joint venture profits as having

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[23] Formal and informal joint ventures, which could be chilled by a continued duty to deal, have various efficiency-enhancing features. *See, e,g.*, *NCAA v. Board of Regents*, 468 U.S. 85, 103 (1984); *United States v. Addyston Pipe & Steel Co.*, 85 F.2d 271 (6th Cir. 1898), *aff'd as modified*, 175 U.S. 211 (1899); Joseph F. Brodley, *Joint Ventures and Antitrust Policy*, 95 Harv. L. Rev. 1521, 1525-29 (1982); Dennis W. Carlton & J. Mark Kalmer, *The Need for Coordination Among Firms, with Special Reference to Network Industries*, 50 U. Chi. L. Rev. 446, 453 (1983). Note also that imposing a continuing duty to deal transforms joint ventures into something in the nature of a merger. This can be harmful not only to the parties but also to society generally.

[24] Herbert Hovenkamp et al., *Unilateral Refusals to License*, J. Comp. L. & Econ. 1, 30 (June 2006).

[25] *See* Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal--Why Aspen and Kodak Are Misguided*, 68 Antitrust L.J. 659 (2001).

anything to do with antitrust."[26] Perhaps most important of all, the Court's effort to cabin *Aspen* could produce a perverse doctrine that hinges liability on preexisting relationships.

B. *Essential Facilities*

The essential facilities "doctrine" is a subset of refusals to deal. Before *Trinko*, lower courts suggested essential facilities may be a separate basis for Section 2 liability. The best known case for this principle is *MCI Communications Corp.* v. *AT&T*, 708 F.2d 1081 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983).[27] In that case, the Seventh Circuit articulated a four-part test that requires the plaintiff to show "(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."[28]

In *Trinko*, the plaintiffs attempted to characterize their claim as an essential facilities claim, in addition to a refusal to deal claim. The Supreme Court gave the essential facilities argument short shrift. The Court initially noted that "[w]e have never recognized such a doctrine, and we find no need either to recognize it or to repudiate it here."[29] The Court explained that "[i]t suffices for present purposes to note that the indispensable requirement for invoking the doctrine is the unavailability of access to the 'essential facilities'; where access

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[26] *Id.* at 677.

[27] One author has noted that *MCI* is "apparently the first and only case of liability for unilateral firm conduct under the 'essential facilities doctrine.'" John Thorne, *A Categorical Rule Limiting Section 2 of the Sherman Act: Verizon v. Trinko*, 72 U. Chi. L. Rev. 289, 298 (2005). AT&T apparently did not even contest the validity of the "essential facilities" theory in this case.

[28] *Id.* at 1132-33.

[29] 540 U.S. at 411.

exists, the doctrine serves no purpose."[30] Because the 1996 Act's forced sharing provisions provided such access, no essential facilities claim could be stated.

For many of the same reasons discussed above and others, the notion of an essential facilities "doctrine" should be rejected explicitly by the courts and agencies.[31] As Areeda and Hovenkamp have explained, the doctrine is harmful because "[f]orcing a firm to share its monopoly is inconsistent with antitrust basic goals for two reasons. First, consumers are no better off when a monopoly is shared; ordinarily, price and output are the same as they were when one monopolist used the input alone. Second, the right to share a monopoly discourages firms from developing their own alternative inputs."[32] I would add to the list of reasons why the doctrine should disappear the inevitability of false positives and the inability of courts to decide and manage the terms of sharing.

Some lower courts have falsely perceived essential facilities as a stand-alone basis for liability. Under this reasoning, proof of an "essential facility" obviates the need to prove exclusionary or predatory conduct. This mistake was made by the lower court in *Trinko*, which found that an "essential facilities" claim was stated because the Complaint alleged the network

[30] *Id.*

[31] As Professor Hovenkamp has pointed out, *Trinko* effectively destroyed the essential facilities theory in many respects. *See* Herbert Hovenkamp, *The Antitrust Enterprise* 248 (2005) ("*Trinko* effectively may have brought the era of antitrust essential facility claims to an end, certainly in regulated industries where an agency is actively supervising the conduct that forms the basis of an antitrust claim.").

[32] 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 771, at 171-72 (2d ed. 2002).

element at issue was essential and prohibitively expensive to produce, and Verizon had denied access on "reasonable" terms.[33]

The most that can be said is that "essential facilities" is "a label that may aid in the analysis of a monopoly claim, not a statement of a separate violation of law."[34] But even thinking about it in this way may be counterproductive. At bottom, a plaintiff making an essential facilities argument is saying that the defendant has a valuable facility that it would be difficult to reproduce, and suggesting that is a reason for a court to intervene and impose a sharing duty. But at least in the vast majority of the cases, the fact that the defendant has a highly valued facility is a reason to *reject* sharing, not to *require* it, since forced sharing "may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities."[35]

IV. Objective And Accessible Section 2 Standards

The criticisms leveled at the standardless nature of Section 2 law have reached a high-water mark. A Background Note prepared for the OECD's Competition Committee highlighted the depth of current difficulties with a survey of scholarly literature and expressed severe disapproval of the current state of the law.[36] Einer Elhauge has written that exclusionary conduct doctrine "uses a barrage of conclusory labels to cover for a lack of any well-defined criteria for

[33] *See* Brief for the United States and the Federal Trade Commission as Amici Curiae Supporting Petitioner, *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, No. 02682, at 20-22 (May 2003).

[34] *Viacom Int'l, Inc. v. Time Inc.*, 785 F. Supp. 371, 376 n.12 (S.D.N.Y. 1992).

[35] *Trinko*, 540 U.S. at 408.

[36] *See* Competition Committee, Directorate for Financial and Enterprise Affairs, Organisation for Economic Co-operation and Development, Competition on the Merits – Background Note, DAF/COMP(2005) 17, at 6-7 (May 9, 2005).

sorting out desirable from undesirable conduct that tends to exclude rivals."[37] Even Eleanor Fox, who has often favored intrusive and expansive liability rules, agrees that "[a] number of contemporary cases on exclusionary practices tend to be noncommittal if not obfuscatory" in their usage of terms such as "anticompetitive."[38]

Uncertain legal and regulatory regimes -- like limits on investment -- are strong deterrents to investment and innovation. The idea is so accepted that it needs little elaboration. Just read the press and studies on investments to see the dangerous role of uncertainty.[39] The

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[37] Elhauge, *Defining Better Monopolization Standards, supra* note 22, at 342.

[38] Eleanor Fox, *What is Harm to Competition? Exclusionary Anticompetitive Effect*, 70 Antitrust L.J. 371, 383 (2002); *see also* Richard A. Epstein, *Monopoly Dominance or Level Playing Field? The New Antitrust Paradox,* 72 U. Chi. L. Rev. 49, 55 (2005) ("But § 2 cases lack a strong theory of why the practices in question count as social harms at all, for, unlike the standard theory against cartels, there is no comparably strong theory that undergirds § 2, which deals with monopolization or attempts at monopolization."); Herbert Hovenkamp, *Exclusion and the Sherman Act*, 72 U. Chi. L. Rev. 147, 147-48 (2005) ("Notwithstanding a century of litigation, the scope and meaning of exclusionary conduct under the Sherman Act remain poorly defined.").

[39] *See, e.g., Video Regulation Hurdles Outlined by SBC, Verizon Officials,* Communications Daily (November 17, 2005) ("Debate over which regulatory regime should be applied to Bells concerns Wall Street, the Bell executives said in response to our question. 'The regulatory uncertainty is clearly something that may be affecting us,' said [Brent Olson, SBC Services Asst. VP - Regulatory Policy]. Investors 'are worried that the regulatory environment is not necessarily conducive to doing what they want,' he said. 'It is affecting us on Wall Street, said [David Young, Verizon VP - Regulatory Affairs]. 'When we announce we are spending money, it makes our investors nervous.'"); James W. Bunger, *Exploration of oil shale needs federal prodding,* The Denver Post, at E-05 (June 19, 2005) ("Industry sees oil shale as just such a risky investment. Lack of government policy, lack of resource access, immature technology, uncertain regulatory requirements and prospects of oil price downturns pose a risk to investment."); Chris Kraul and Nancy Rivera Brooks, *Officials Go From Cold To Hot on Power Projects*, Los Angeles Times, at A1 (September 4, 2000) (noting that some energy companies "are reconsidering future investment because of the uncertain regulatory climate in the state"); *International Trade Reporter*, Vol. 22, No. 35 (November 8, 2005) (according to a poll by Mexico's Central Bank and the Economy Ministry, legal uncertainty and political uncertainty cited as two reasons for lack of investment in Mexico); Heritage Foundation 2006 Index of Economic Freedom: Russia (citing a U.S. Department of Commerce Report that states: "The

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agencies and courts should aim to provide clear Section 2 standards to guide businesses. At a basic level, only some form of price-cost comparison can provide reliable rules for decision. Certainly the standard should not be based on inquiries into intent. It also should not rely on vague principles like "fairness."

There has remained in the case law an unfortunate reliance on intent in determining what conduct is "exclusionary." This is done both explicitly and implicitly.[40] Either way, relying on intent is not helpful at best and misleading at worse. Judge Posner provided this helpful comparison of the role of intent in antitrust versus other fields in *Olympia*.

> The importance of intent in such fields as tort and criminal law makes it natural to suppose that it should play an important role in antitrust law as well, for an antitrust violation is a statutory tort. But there is an insoluble ambiguity about anticompetitive intent that is not encountered in the ordinary tort case. If A strikes B deliberately, we are entitled to infer, first, that A's act was more dangerous than if the blow had been accidental (you are more likely to hurt someone if you are trying to hurt him than if you are trying, however ineptly, to avoid hurting him, as in the typical accident case), and, second, that the cost of avoidance to the injurer would have been less than if the blow had been accidental; indeed, the cost of forebearing to commit an act of deliberate aggression is negative, because the act requires effort. Similar inferences would be possible in antitrust cases if the purpose of antitrust law were to protect the prosperity or solvency (corresponding to the bodily integrity of potential tort victims) of competitors, but it is not. Competition, which is always deliberate, has never been a tort, intentional or otherwise. *See Keeble v. Hickeringill,* 11

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uncertainty and lack of clarity of Russian tax law and administration, inconsistent government regulations, the unreliability of the legal system as well as crime and corruption all dissuade investors."), *available at* http://www.heritage.org/research/features/index/country.cfm?id=Russia.

[40] *See, e.g., Image Technical Services, Inc. v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1997) (applying a "pretext" standard); *LePage's, Inc. v. 3M*, 324 F.3d 141, 158 (3d Cir. 2003) (referring to the plaintiff's evidence that 3M's rebates to retailers "were designed to induce them" to refuse to deal with the plaintiff); *id.* at 163 (concluding that the jury had sufficient evidence to determine that "3M intended to force LePage's from the market," and referring to 3M executives' statements that large retailers "had no choice but to adhere to 3M's demands").

> East. 574, 103 Eng.Rep. 1127 (K.B. 1706 or 1707). If firm A through lower prices or a better or more dependable product succeeds in driving competitor B out of business, society is better off, unlike the case where A and B are individuals and A kills B for B's money. In both cases the "aggressor" seeks to transfer his victim's wealth to himself, but in the first case we applaud the result because society as a whole benefits from the competitive process. That Western Union wanted to "flush these turkeys" tells us nothing about the lawfulness of its conduct.[41]

Intent then wrongly focuses the decisionmaker on the competitor, not competition. Intent also wrongly shifts the inquiry from objective to subjective. What antitrust should be concerned about is not the state of mind, but the methods businesses use to compete and the effects of those methods.[42] If there is a valid business justification for an action, which does not harm competition, that should be the end of the matter.

It is simply too dangerous to task a jury with distinguishing the intent to create a monopoly anticompetitively from the intent to do so competitively.[43] Sound bites from a defendant's business plans or internal memoranda may sound impressive (or aggressive) when read to a jury, but have little bearing on the ultimate question of anticompetitive effects. Relying upon such misleading evidence is likely to increase the costs and burdens of litigation and reduce the accuracy of decisions. Taken to its extreme, intent-based adjudication also could have the

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[41] 797 F.2d at 380.

[42] *Gen. Leaseways, Inc. v. Nat'l Truck Leasing Ass'n*, 744 F.2d 588, 595-96 (7th Cir. 1989) ("We attach rather little weight to internal company documents used to show anticompetitive internal company documents used to show anticompetitive intent, because, though they sometimes dazzle a jury, they case only a dim light on what ought to be the central question in an antitrust case: actual or probable competitive effect.").

[43] Herbert Hovenkamp, *The Monopolization Offense*, 61 Ohio St. L.J. 1035, 1039 (2000) ("[T]he 'intent' to create a monopoly anticompetitively cannot be distinguished from the intent to do so competitively.").

following odd effect: Two actors engage in identical conduct, and only one -- the one the jury believes to have been motivated by impure thoughts -- is found liable under Section 2. In a system concerned about *effects on competition*, that result make little sense.[44]

Apart from reliance on intent, another troubling trend in Section 2 case law is standardless jury instructions and adjudication. *Confederated Tribes of Siletz Indians of Oregon v. Weyerhaeuser*, 411 F.3d 1030 (9th Cir. 2005), provides an example. In *Weyerhaeuser*, a lumber company claimed that its competitor had engaged in "predatory bidding" in driving it from the market. The jury was instructed on this claim as follows:

> One of [plaintiff's] contentions in this case is that [defendant] purchased more logs than it needed or paid a higher price for logs than necessary, in order to prevent [plaintiff] from obtaining the logs [it] needed at a fair price. If you find this to be true, you may regard it as anticompetitive.[45]

Nothing anchored the terms "necessary" or "fair" to any objective benchmark. The Court rejected a modified *Brooke Group* test, under which a plaintiff would have to prove short-term losses and the possibility of recoupment. Instead, the jury was left to determine whether a multimillion verdict was appropriate based on its subjective determination of what is right and wrong in log buying. The Supreme Court has granted certiorari, hopefully to correct this error.

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[44] Some courts and commentators take the view that evidence of intent can help determine effects, and to that extent is useful. For example, the D.C. Circuit in *Microsoft* explained: "[O]ur focus is upon the effect of that conduct, not upon the intent behind it. Evidence of the intent behind the conduct is relevant only to the extent that it helps us understand the likely effect of the monopolist's conduct." *United States v. Microsoft Corp.*, 253 F.3d 34, 59 (D.C. Cir. 2001). That is unobjectionable as far as it goes. But a trial court that allows too much of this evidence, or an appellate court that pays it too much heed, risks diverting the case from the proper effects-based analysis. Juries should be instructed that intent-based evidence is only relevant to the extent it informs the effects question, and that intent is not a basis for liability.

[45] *See* Brief for the United States as Amicus Curiae, *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, No. 05-381, at 3 (May 2006).

LePage's, Inc. v. 3M, 324 F.3d 141 (3d Cir. 2003), also illustrates the need for some type of standard. The Third Circuit affirmed a plaintiff's jury verdict imposing Section 2 liability on 3M for bundled rebates and exclusive dealing arrangements. In so doing, however, the Third Circuit neither required LePage's to show that it was unable to make offers comparable to 3M's nor that it would have been impossible for an equally efficient rival to compensate for 3M's offers. It was undisputed that 3M's prices were above any appropriate measure of cost. But the Court rejected a modified *Brooke Group* test. As Tim Muris' testimony before the Antitrust Modernization Commission illustrates, that test would provide significant benefits in this area.[46] Other tests might also provide clearer guidance. But imposing liability without any objective rule for decision injures competition rather than protecting it.

V. **Conclusion**

Scholars and courts will continue to debate the specifics of liability under Section 2. The Antitrust Division and the Commission have advocated the "no economic sense" standard as appropriate for determining what acts are "anticompetitive" under Section 2.[47] So long as this test is used appropriately -- to screen out meritless cases and to provide businesses guidance -- it can be useful. The key point of my testimony today is that the present state of confusion only harms competition and reduces investment. Certainly, there is no empirical basis for believing application of the current standards in our hugely expensive litigation system has been beneficial

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[46] *See* Timothy J. Muris, *Comments on Antitrust Law, Economics, and Bundled Discounts*, Submitted on Behalf of the United States Telecom Association in Response to the Antitrust Modernization Commission's Request for Public Comments (July 15, 2005).

[47] *See* Brief for the United States and the Federal Trade Commission as Amici Curiae Supporting Petitioner, *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, No. 02682 (May 2003).

to consumers. The Antitrust Division and Commission could do a great service by continuing to push for more objective and less intrusive standards.