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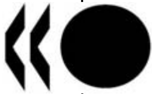

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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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ROUNDTABLE ON REFUSALS TO DEAL

-- Note by the United States --

This note is submitted by the Delegation of the United States to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 17-18 October 2007.

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1. More than eighty years ago, the Supreme Court set out the fundamental principle that still guides consideration of cases involving refusals to deal in the United States. As the Court stated in *United States* v. *Colgate*,[1] "in the absence of any purpose to create or maintain a monopoly, the Sherman Act does not restrict the long-recognized right of a trader or manufacturer engaged in any entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal."[2] Accordingly, refusals to deal are actionable only when done by a firm creating or maintaining a monopoly power. Moreover, the refusal must harm, not only the targeted firm, but also the competitive process.[3]

2. While these are basic principles, the analytical standards to be used in determining whether a monopolist may refuse to deal are not. As discussed below, efficiency considerations and the difficulty of fashioning remedies complicate the consideration of what standards and tests should be applied in determining whether a monopolist's refusal to deal with a rival should be condemned under the antitrust law, and, indeed, whether a monopolist's unconditional refusal to deal with a rival should be actionable at all.[4]

3. In this paper we consider a monopolist's refusal to deal with rivals, focusing primarily on the policy considerations underlying enforcement policy in this area and the Supreme Court's recent articulation of those considerations in its most recent case involving refusals to deal, *Verizon Commcs Inc*. v. *Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

1. Leading Supreme Court Decisions

4. The Supreme Court has held that a monopolist's unilateral refusal to deal with its rival under some circumstances can violate Section 2 of the Sherman Act. For example, in one case, *Otter Tail Power Co.* v. *United States*,[5] the Court upheld an injunction requiring a firm to sell electric power at wholesale to towns seeking to establish their own municipal power systems and also to transmit electricity generated by other power companies, explaining that the firm's "refusals to sell at wholesale or to wheel were solely to

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1 United States v. Colgate & Co., 250 U.S. 300 (1919).

2 *Id.* at 307.

3 *See* Aspen Skiing Co. v. Aspen Highlands Skiing Corp. , 472 U.S. 585 (1985) ("the question whether [the defendant's] conduct may properly be characterised as exclusionary cannot be answered by simply considering its effect on [the plaintiff]" but must consider its effect on competition); United States v. Dentsply International, 399 F.3d 181 (3d Cir. 2005), S. ("there must be proof that competition, and not merely competitors, has been harmed") , *cert. denied,* 126 S. Ct. 1023 (2006); United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001) (act must "harm the competitive process and thereby harm consumers. . .In contrast, harm to one or more competitors will not suffice").

4 These difficulties were addressed during the 2006-2007 hearings on unilateral firm conduct sponsored by the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission. One of the hearings specifically considered refusals to deal with rivals. A transcript of that hearing, and transcripts of the other hearings as well as other materials submitted as part of the hearings record are available on the web sites of the Department of Justice (http://www.usdoj.gov/atr/public/hearings/single-firm/sfctranscripts.htm) and the Federal Trade Commission (http://www.ftc.gov/os/sectiontwohearings/). The Agencies intend to publish a report on the hearings, which will discuss, among other topics, unilateral refusals to deal with rivals, and the analytical standards that the agencies believe should be used in determining when, if ever, such conduct should be actionable under Section 2 of the Sherman Act.

5 410 U.S. 366, 368 (1973).

prevent municipal power systems from eroding its monopolistic position."[6] In another case, *Aspen Skiing Co.* v. *Aspen Highlands Skiing Corp.*,[7] the Court held that a firm controlling three of the four skiing facilities in Aspen, Colorado violated Section 2 by refusing to continue offering with the operator of the fourth facility a joint lift ticket that could be used at all four facilities. Characterizing the refusal to continue offering a joint ticket as "a decision by a monopolist to make an important change in the character of the market," the Court affirmed a $7.5 million judgment for the plaintiff, explaining that the evidence permitted the jury to conclude "that there were no valid business reasons for the refusal" and that the firm's actions could be deemed "predatory" if it "has been attempting to exclude rivals on some basis other than efficiency."[8] Finally, in *Eastman Kodak Co.* v. *Image Tech. Servs., Inc.*, 504 U.S. 451 (1992), the Supreme Court remanded for trial a case involving Kodak's refusal to sell Kodak parts to various independent service operators, explaining that although "it is true as a general matter a firm can refuse to deal with its competitors, "that right is not absolute; it exists only if there are legitimate competitive reasons for the refusal."[9]

5. For many years, the Court's analysis of refusals to deal primarily considered whether the defendant was able to offer a valid business justification for its conduct. However, in its most recent decision in *Trinko,* the Court strongly suggested that the courts should exercise additional caution in this area. Interestingly, *Trinko* did not involve a true "refusal" to deal, but rather a claim that the defendant monopolist had provided inadequate interconnection services to its rivals under federal and state telecom regulations. Although the Court did not overrule any of its prior precedents, it declared that *Aspen Skiing* (which it termed the "leading case for §2 liability based on refusal to cooperate with a rival")[10] was "at or near the outer boundary of liability,"[11] and carefully distinguished the facts of *Aspen Skiing* from the those in *Trinko*,[12] stating that the courts should be "very cautious" about recognizing exceptions to the general principle that firms have the right to choose those with which they will deal "because of the uncertain virtue of forced sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm."[13] Expanding on this theme, the Court noted that forcing firms to share assets may diminish innovation, lead to collusion and involve the courts in regulatory roles to which they are ill-suited:

> Firms may acquire monopoly power by establishing an infrastructure that renders them uniquely suited to serve their customers. Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of the antitrust laws, since it may lessen the incentive for the monopolist, the rival, or both to invest in these economically beneficial facilities. Enforced sharing also requires antitrust courts to act

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6 *Id.* at 368.

7 472 U.S. 585 (1985).

8 504 U.S. 451 (1992).

9 *Id.* at 486.

10 540 U.S. at 408.

11 540 U.S. at 409.

12 In particular, the Court noted that the defendant in *Trinko* had not had a prior voluntary course of dealing which it later terminated, that its actions were not contrary to its short-term economic interest as was the case in *Aspen Skiing*, and that the services at issue in *Trinko*, unlike those in *Aspen Skiing,* were "not marketed or available to the public." *Id*. at 409-410.

13 *Id.*

> as central planners, identifying the proper price, quantity, and other terms of dealing–a role for which they are ill-suited. Moreover, compelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion.[14]

6. Thus, the Court reaffirmed the general rule that the Sherman Act "does not restrict 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,"[15] and concluded that there were sound reasons for not creating any additional exceptions to the rule.

7. Commentators generally view the Court's 2004 decision in *Trinko* as suggesting an important doctrinal shift away from holding firms–even those with monopoly power–liable for unilateral refusals to deal with rivals except under the rarest of circumstances. Nevertheless, it is also generally recognized that *Trinko* did not provide any concrete guidance as to precisely which standards or tests should be used to determine what those circumstances should be.

8. In *Trinko,* the Department of Justice and the Federal Trade Commission had filed a joint brief, urging the Court to adopt the "no economic sense" test for evaluating whether refusals to deal with a rival were unlawful. Under that test, "where a plaintiff asserts that the defendant was under a duty to assist a rival. . .conduct is not "exclusionary" or "predatory" unless it would make no economic sense for the defendant but for its tendency to eliminate or lessen competition."[16] Explaining that such "cases required a sharper focus" because of the dangers posed by false positives and the potential chilling of procompetitive behaviour, the Agencies urged the Court to adopt the more demanding "no economic sense" test for refusals to deal with rivals. While the Court did not adopt the test, it did signal its apparent agreement with the underlying policy concerns highlighted by the Agencies in their joint brief.

2. Lower Court Cases

9. Historically, some lower courts have decided refusal to deal cases under the rubric of the "essential facilities doctrine," which generally stands for the proposition that the antitrust laws require a firm in control of a facility essential to its competitors to provide reasonable access to the facility if possible.[17] But the Supreme Court has never endorsed that doctrine, and many commentators (including the United States Department of Justice and the Federal Trade Commission) criticize it, noting that it

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14 *Id.*

15 540 U.S. at 407-08 (quoting United States v. Colgate & Co., 250 U.S. 300, 307 (1919)).

16 Brief for the United States and the Federal Trade Commission as Amici Curiae Supporting Petitioner Verizon Commc'ns, at 15.

17 *See, e.g.*, MetroNet Servs. Corp. v. Qwest Corp., 383 F.3d 1124, 1129 (9th Cir. 2004); MCI Commc'ns Corp. v. Am. Tel. & Tel. Co., 708 F.2d 1081, 1132-33 (7th Cir. 1983); Hecht v. Pro-Football, Inc., 570 F.2d 982, 992 (D.C. Cir. 1977); United States v. Am. Tel. & Tel. Co., 524 F. Supp. 1336, 1352-53 (D.D.C. 1982). Probably the most frequently cited formulation of the doctrine is that in MCI Commc'ns Corp. v. AT&T, 708 F.2d 1081, 1132-33 (7th Cir. 1983) where the court found AT&T liable for refusing to sell services to MCI, a competitor. There the Court set out the four elements necessary to establish liability under the essential facilities doctrine, namely (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) providing access was feasible.

provides no clear answers as to what constitutes such a facility, what makes such a facility essential, and what constitutes a denial of access.[18]

10. Post-*Trinko* lower court decisions have generally concluded that monopolists have no duty to deal with rivals.[19] Some have interpreted *Trinko* to bar refusal to deal claims in instances in which there was no voluntary prior course of dealing or where the defendant's conduct was profitable.[20] While the lower courts have allowed a few cases to proceed where the defendant has changed a prior course of dealing and acted contrary to its own short-term interest,[21] most commentators and courts view *Trinko* as having articulated a very high bar for finding that a competitor has any kind of duty to deal with its rivals.

11. *Trinko,* however, did not provide specific guidance on what standards or tests should be used to assess refusals to deal with a rival, and there remains significant uncertainty in this areas as was illustrated by the Agencies recent hearings on unilateral firm conduct. Some of the important policy considerations to be taken into account in determining what those standards should be are considered below.

3. Policy Considerations

12. The uncertainty regarding the legal standards governing allegedly harmful refusals to deal reflects the uncertainty regarding two key policy issues: (1) when, if ever, forcing a firm to deal with a rival is beneficial and (2) whether the antitrust laws should be used to remedy allegedly harmful refusals to deal with a rival.

13. Commentators have debated the first issue extensively without achieving consensus. The crucial problem is "the well-known tradeoff between . . . static efficiency benefits . . . on the one side, and the

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18 *See, e.g.*, 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 771c (2d ed. 2002) ("the essential facility doctrine is both harmful and unnecessary and should be abandoned"); Abbott B. Lipsky, Jr. & J. Gregory Sidak, *Essential Facilities*, 51 STAN. L. REV. 1187, 1195 (1999) ("mandatory access remedies, such as the essential facilities doctrine, do not fit comfortably within antitrust law"); Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles*, 58 ANTITRUST L.J. 841, 841 (1990) (asserting that essential facilities "is less a doctrine than a epithet, indicating some exception to the right to keep one's creations to oneself, but not telling us what those exceptions are"); Gregory J. Werden, *The Law and Economics of the Essential Facility Doctrine*, 32 ST. LOUIS U. L.J. 433, 480 (1987) ("courts should reject the doctrine"); Michael Boudin, *Antitrust Doctrine and the Sway of Metaphor*, 75 GEO. L.J. 395, 402 (1986) (noting "embarrassing weakness" of essential facilities doctrine).

19 *See* ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS, 6th ed. at 260 ("Decisions after Trinko have recognised that a monopolist does not have a duty to deal with its rivals absent unusual circumstances.") & nn. 220-223 (collecting cases).

20 *Id.* at 261, & n.222 (collecting cases); see, e.g., Covad Commc'ns. Co. v. Bell Atl. Corp., 398 F.3d 666, 673 (D.C. Cir. 2005) ("An antitrust claim based upon the defendant's refusal to cooperate with its competitor can withstand a motion to dismiss only when it is alleged either that the defendant had previously engaged in a course of dealing with its rivals, or [that it] would ever have done so absent statutory compulsion"); MetroNet Servs. Corp.v. Qwest Corp., 383 F.3d 1124. 1132 (9th Cir. 2004) (no antitrust liability where defendant terminated prior course of dealing because that prior course was unprofitable), *cert. denied*, 544 U.S. 1049 (2005).

21 See ANTITRUST LAW DEVELOPMENTS, at 261. None of those cases held that Section 2 was violated.

contribution to welfare stemming from the growth deriving from a generous payoff incentive for innovation investment on the other side."[22]

14. On the static side of the tradeoff, forced sharing may help consumers through direct effects on price and output. Some firms possess monopoly power, which is "the ability '(1) to price substantially above the competitive level *and* (2) to persist in doing so for a significant period without erosion by new entry or expansion.'"[23] Economists have long maintained that, in a monopoly market, "less is sold than if the market were competitive . . . and society suffers a deadweight loss."[24] Forcing a monopolist to deal with a rival on terms that would otherwise be unacceptable might counteract that loss by providing greater output at lower cost.

15. The dynamic side of the tradeoff concerns innovation—whether the creation of new products or new ways to lower costs—and its crucial role in driving economic growth.[25] Innovation often results from investments, and firms make investment decisions based on anticipated returns.[26]

16. Rules mandating forced sharing on otherwise undesirable terms lowers the anticipated return from valuable assets, thereby decreasing the incentive of firms to make investments designed to create new valuable assets. As one commentator puts it, "[t]he major point is self-evident: if innovators are forced to license their discoveries and to do so at bargain prices, it creates a strong disincentive to investment in the expensive and risky innovation process."[27] Accordingly, many question whether antitrust rules that require forced sharing will slow the pace of innovation and thus inflict long-run harms eclipsing their short-term benefits.[28]

17. The second issue—whether the antitrust laws should be used to remedy allegedly harmful refusals to deal with a rival—concerns the desirability of regulating industrial relations through antitrust litigation as opposed to direct regulation.[29] Many commentators are concerned about the difficulty of

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22 WILLIAM J. BAUMOL, THE FREE-MARKET INNOVATION MACHINE 121 (2002).

23 AD/SAT v. Associated Press, 181 F.3d 216, 227 (2d Cir. 1999) (quoting 2A PHILLIP E. AREEDA ET AL., ANTITRUST LAW ¶ 501, at 86 (1995)); *see also* United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 391 (1956) (defining monopoly power as "the power to control prices or exclude competition").

24 DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 88 (4th ed. 2005).

25 *See, e.g.*, JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 85-86 (Harper Perennial 1976) (1942) (observing that "competition from the new commodity, the new technology, the new source of supply, the new type of organization" is "the powerful lever that in the long run expands output and brings down prices"); Robert M. Solow, *Technical Change and the Aggregate Production Function*, 39 REV. ECON. STUDIES 312, 320 (1957) (asserting that, in the United States between 1909 and 1940, "[g]ross output per man hour doubled . . . with 87½ per cent of the increase attributable to technical change").

26 The Court explained in *Trinko*, "[t]he 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." Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

27 BAUMOL, *supra* note 3, at 217.

28 *See* discussion *supra* at 4.

29 *Ibid.*

regulating industry through antitrust litigation. One view is that forced dealing imposes on courts obligations that they cannot perform:

> [O]nce we get into the issue of fair compensation for the manufacturer's past R&D expenditures or simply fair compensation for his creative success, we are in a hopeless situation. It is hard enough for courts to determine marginal production costs. How would a court ever assess how much a firm should be fairly rewarded for its creative efforts?[30]

18. Similarly, Judge Posner advocates "abandon[ing]" the principle that "a unilateral refusal to deal, if monopolistic in its likely effect, is actionable" under United States antitrust law in view of the remedial difficulties raised when firms are forced to cooperate with rivals[31]:

> The problem is remedy. A decision enjoining a group refusal to deal . . . does not require anyone to deal with anyone else. An *agreement* among a group of firms not to deal is dissolved, leaving the individual firms comprising the group free to deal or not to deal with the boycotted firm as they wish; no one is ordered to do business with anyone else. Where the refusal to deal is unilateral, the only effective remedy is an order that the defendant do business with the victim of the refusal to deal. The antitrust court becomes charged with the supervision of an ongoing commercial relationship, a function that courts are not equipped to perform effectively.[32]

19. Judge Posner concludes that it "cannot be sound antitrust law that, when Congress refuses or omits to regulate some aspect of a natural monopolist's behaviour, the antitrust court will step in and, by decree, supply the missing regulatory regime."[33]

20. Professor Hovenkamp raises the same concern, asserting that forcing a firm to cooperate with rivals is appropriately dealt with through regulation, not the antitrust laws. While acknowledging that forced cooperation has the potential to be beneficial where "firms have extraordinary amounts of very durable market power,"[34] he concludes that, "[w]hile price-regulated monopoly may sometimes be appropriate, that decision must be made by a legislature, and never via the antitrust laws," because "a compulsory sales rule turns the defendant into a public utility and places the court in the indefensible position of a price regulator."[35]

4. Refusals to Deal with Customers, Dealers, and Others

21. Although U.S. antitrust law on refusals to deal specifically addresses refusals to deal with a rival, there are many other practices that can be broadly labelled refusals to deal that do not directly involve agreements to deal (or the lack thereof) between rivals. Any manufacturer who refuses to supply all

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30 George A. Hay, *A Monopolist's "Duty to Deal": The Briar Patch Revisited*, 3 SEDONA CONF. J. 1, 5 (2002).

31 RICHARD A. POSNER, ANTITRUST LAW 242 (2d ed. 2001).

32 *Id.*

33 *Id.* at 243-44.

34 HERBERT HOVENKAMP. THE ANTITRUST ENTERPRISE 158 (2005).

35 *Id.* at 270.

would-be dealers is refusing to deal with some. U.S. antitrust law rarely, if ever, intervenes when a manufacturer unilaterally, unconditionally refuses to deal with any particular party, including customers. However, to the extent a refusal is conditional (i.e., I will deal with you only if you agree not to deal with my competitor), competitive concerns can arise in particular circumstances. Typically, to violate the antitrust laws, the practice must be imposed by a party with monopoly power, the practice has to involve significant foreclosure, business justifications, if any, for the practice must be rebutted, and the practice must contribute to the maintenance of the monopoly and harm competition, not just one or a group of competitors.

22. Recently, in *United States* v. *Dentsply International*,[36] the Third Circuit held that the dominant manufacturer of artificial teeth in the United States violated Section 2 of the Sherman Act by prohibiting its independent distributors from carrying competing brands of teeth. The court determined that access to these independent distributors was critical to competing in the market. After finding that there was no plausible procompetitive justification for the policy, the Court held that Dentsply's conditional refusal to deal with its distributors violated Section 2.

23. Similarly, in *United States* v. *Microsoft Corp*.,[37] the Court held that Microsoft's threatened reprisals against customers and suppliers for cooperating with its competitors was unlawful conduct under Section 2. The Court found that Microsoft's conduct had impeded its rivals from being able to distribute and sell their products, thereby harming competition, and that Microsoft had failed to offer any procompetitive justification for its conduct. Accordingly, the Court, using a rule of reason analysis, concluded that the conduct was unlawful under Section 2 since it served to entrench Microsoft's operating system monopoly, and there was no offsetting procompetitive justification.

24. In most other cases involving unilateral refusals to deal, however, the plaintiffs have been unsuccessful, usually because they have failed to show that the allegedly unlawful conduct harmed competition. Thus, for example, in *Intergraph Corp*. v. *Intel Corp*.,[38] the Court reversed a lower court ruling holding that Intel's discontinuation of technical assistance and pre-release access to Intel's new products to the plaintiff in retaliation for the plaintiff's filing a patent suit against Intel violated Section 2. The Court explained that "the antitrust laws do not require it to give preferred treatment to a customer that is suing it," and rejected the plaintiff's Section 2 claims because "onerous actions do not in themselves constitute antitrust violations" and because Intel's refusal to deal with a customer did not harm competition.

[36] 399 F.3d 181 (3d Cir. 2005).

[37] 253 F.3d 34 (D.C. Cir. 2001).

[38] 195 F.3d 1346 (Fed. Cir. 1999).