ESSENTIAL FACILITIES AND REGULATION: COURT OR AGENCY JURISDICTION?

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Thank you. I appreciate the opportunity to participate in today's program on exclusionary practices and the "cutting edge" of antitrust law, with our focus for the moment on the essential facilities doctrine. Before saying anything about essential facilities, let me offer an essential disclaimer: the views I express today are my own, and are not necessarily the views of the Federal Trade Commission or any other commissioner.

The specific topic that our panel has been asked to address is "Essential Facilities and Regulation: Court or Agency Jurisdiction?" The Federal Trade Commission is, of course, an agency, but by and large it does not consider itself a regulatory agency. In the context of our assigned topic, I understand the reference to regulation under court jurisdiction to mean the application of the antitrust laws -- either by the courts in antitrust litigation or by antitrust enforcement agencies like the Federal Trade Commission -- to essential facilities.

I also understand that regulation under agency jurisdiction refers to more direct regulation of essential facilities by agencies such as the Federal Energy Regulatory Commission or a state public utilities commission. Of course, such an agency might choose to apply antitrust principles in addition to or instead of other regulatory standards, in which case the issue would not be which regulatory philosophy is more appropriate, but rather who is better able to implement that philosophy.

One point of view is that disputes over access to essential facilities should be resolved in industry-wide regulatory proceedings rather than through antitrust enforcement. According to one commentator,

> [T]he essential facility doctrine should not be invoked unless there is a pre-existing regulatory agency capable of adequately supervising relief, and there are a number of reasons for completely eliminating the doctrine as an antitrust cause of action. Essential facility issues are best addressed on an industry-wide basis, through legislation or administrative regulation.[1]

If you come from the FTC, this kind of argument, if it does not elicit knee-jerk opposition, at least raises a red flag. Although regulation may be preferable to antitrust enforcement in some cases, regulation is not necessarily a panacea for all problems. For one thing, regulation imposes obvious costs. Indeed, the cost of regulation is a concern that the Commission raises repeatedly -- some might say endlessly and tiresomely -- in various forums.

Antitrust policy, on the other hand, not only encourages economic efficiency, but it usually does so without creating an abundance of supervisory political machinery. It is also worth keeping in mind that competitive problems controlled through regulation at one point can pop up elsewhere. Regulation of an essential facility that is also a natural monopoly, for example, may encourage the regulated firm to integrate into an

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[1] Werden, The Law and Economics of the Essential Facility Doctrine, 32 St. Louis U.L.J. 433, 479-80 (1987).

unregulated market to evade agency-imposed limits on the profits it can extract from its monopoly.[2]

Instead of attempting to settle the debate over whether regulation of essential facilities is preferable to antitrust enforcement, perhaps I can shed some light on the question by addressing how the Federal Trade Commission has dealt with essential facilities issues, which, in turn, may tell something about what the enforcement agencies can contribute to the resolution of essential facilities problems.

The Federal Trade Commission has never decided a case on the basis of the essential facilities doctrine, so I begin by looking to the courts for a definition of an essential facility. In Hecht v. Pro-Football, Inc.,[3] the Court of Appeals for the D.C. Circuit identified two key characteristics of essential facilities. First, an essential facility is something to which a competitor or potential competitor must have access in order to compete in the relevant market; denial of access to an essential facility inflicts a "severe handicap" on the competitor or potential competitor.[4] Second, an essential facility is something that for practical purposes cannot be duplicated; in the words of the court in Hecht, a facility is essential if it

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[2] Note, Rethinking the Monopolist's Duty to Deal: A Legal and Economic Critique of the Doctrine of "Essential Facilities", 74 Va. L. Rev. 1069 (1988).

[3] 570 F.2d 982 (D.C. Cir. 1977), cert. denied, 436 U.S. 956 (1978).

[4] Id. at 992.

would be "economically infeasible" to duplicate it.[5] It is usually economically infeasible, of course, to duplicate a natural monopoly, and many essential facilities are natural monopolies.

Defining an issue clearly and accurately is often half the battle of understanding it. The cases have not attempted to quantify the characteristics of an essential facility identified in Hecht, so it remains unclear just how essential an essential facility must be. One can imagine one of the enforcement agencies drafting guidelines to define essential facilities. The 1984 Department of Justice Merger Guidelines state that the Department is unlikely to challenge a merger if entry into the relevant market can occur in two years or less. If the Department or the Commission were to develop guidelines for essential facilities cases, we might decide that one factor to consider in deciding whether a facility is essential is how long it would take for a competitor to duplicate it. A facility that could be duplicated in one year probably is less essential than one that would take ten years to duplicate and we could continue to spin out the analysis from there.

The Federal Trade Commission, of course, has not issued guidelines for essential facilities cases. But several FTC cases have involved what were arguably essential facilities, although as I mentioned before, the Commission did not actually use the "epithet," to quote Professor Areeda. In the Reuben H. Donnelly

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5 Id.

case,[6] the respondent was the publisher of the Official Airline Guide, which is usually referred to as the "OAG." The OAG contained up-to-date schedules for all domestic passenger flights. The Commission concluded that there was no "effective substitute" for the OAG:[7]

> The OAG is the only complete listing of scheduled flights in North America; it is the primary source of flight schedule information for the flying public and the primary marketing tool for carriers. . . . It is referred to in the airline industry as the "Bible."
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> . . . .
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> The OAG is recognized in the industry as being unique and indispensable; there are substantial price differences between the OAG and its purported substitutes; and there are distinct users of the OAG for whom no other product will do.[8]

Any airline whose flights were not listed in the OAG would have found it very difficult to compete with airlines whose schedules did appear in that publication, so the OAG certainly met the first test of an essential facility. It is less clear that it would have been "economically infeasible" to duplicate the OAG, but it would not have been easy to do so.

While the OAG was arguably an essential facility, the Donnelly case was not what we have come to think of as the classic essential facilities case. The OAG listed the connecting flights of large interstate air carriers in a very easy-to-use format, but did not list the connecting flights of small commuter

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6 95 F.T.C. 1 (1980).

7 Id. at 64.

8 Id. at 63, 65.

airlines in the same way. Most essential facilities cases involve a refusal by an integrated firm with a monopoly in one market to deal with its competitors in a second market, but Donnelly did not compete in the passenger airline market.

Donnelly was accused of agreeing with the interstate air carriers to place the commuters' connecting flight listings in a less convenient location; if Donnelly had conspired with those airlines, this would have been an easy case. But the Commission found that the evidence did not establish the existence of a conspiracy. Rather, the Commission held that it was a violation of Section 5 of the FTC Act for a monopolist like Donnelly to treat some of its customers better than others when it had no substantial business justification to do so, and when the result would be a lessening of competition in the customers' market. The Court of Appeals for the Second Circuit reversed the Commission,[9] however, holding that a monopolist like Donnelly was free to decide who it would deal with "as long as he has no purpose to restrain competition or to enhance or expand his monopoly."[10] That decision apparently has put an end to "arbitrary refusal to deal" cases like Donnelly, at least at the Commission.

In 1987, the Commission accepted a consent agreement in a Section 7 case in which an essential facilities question arose.

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[9] Official Airline Guides, Inc. v. FTC, 630 F.2d 920 (2d Cir. 1980).

[10] Id. at 927-28.

The consent agreement permitted Alleghany Corporation to purchase Safeco Title Insurance Company but required certain divestitures. One provision of the consent agreement required Alleghany to divest Safeco's title plant in Cook County, Illinois. Alleghany and Safeco owned the only title plants in Cook County. As you probably know, a title plant is a privately owned collection of records regarding the ownership of specific parcels of real property. Keeping a title plant up-to-date requires regular visits to the local recorder's office to obtain copies of newly-filed mortgages, deeds of trust, and other documents.

When the proposed consent agreement was put out for public comment, some of the commenters argued that the Safeco title plant was so inferior to the title plant operated by Chicago Title, an Alleghany subsidiary, that requiring its divestiture would not place much of a check on Chicago Title's market power. Safeco's plant only had records from 1979 to the present, while Chicago Title had records that pre-dated the Great Chicago Fire of 1871. In fact, Chicago Title's plant was the only source of pre-1871 title records because all the public records had burned up in that famous conflagration.

In theory, a new entrant could use the public records to create a title plant that covered 1871 to the present, but that apparently was not a practical alternative. As one of the commenters put it, "conditions in the Cook County Recorder's Office effectively preclude the use of public records to conduct

searches for title insurance underwriting purposes at a competitive price and speed." Those same conditions also would prevent a new entrant from creating a title plant from the public records.

In essence, the commenters were arguing that Chicago Title's plant was an essential facility. Indeed, as one would expect in a Section 7 case, the Commission had alleged that there were substantial barriers to entry into the title plant market in Cook County. This calls to mind the statement in the Hecht case that a facility is essential if it would be "economically infeasible" to duplicate it.

Assuming there was an essential facility problem, that problem was unrelated to and not created by the Alleghany-Safeco merger; Chicago Title's plant and its market power existed before the merger took place. Requiring Alleghany to create and divest a copy of the Chicago Title plant rather than the Safeco plant, as the commenters suggested, would have been a new and inappropriate remedy in the context of a Section 7 case. Section 7 does not provide the authority to require that a market be more competitive after a merger than it was before the merger. To the extent that the Alleghany-Safeco case involved a merger to monopoly, the Commission provided a remedy. To the extent that the case merely brought to light a pre-existing essential facility problem, the Commission left that problem untouched.

If a merger itself results in the creation of an essential facility, the result might be different. In that situation, of

course, the law under Section 7 provides an adequate basis for relief, and there is no need to apply the essential facilities doctrine. Indeed, as Bill Baxter pointed out this morning, U.S. v. Terminal Railroad Association of St. Louis,[11] the granddaddy of all essential facilities cases, could have been challenged under Section 1 or Section 7. In fact, in a recent working paper,[12] two staff economists in the Commission's Bureau of Economics examined the record in that case and came to a similar conclusion.

The essential facility in Terminal Railroad was really a group of facilities: bridges, ferries, tunnels, and connecting tracks. The Terminal Railroad Association, which was the brainchild of railroad magnate Jay Gould, was incorporated in 1889. The Association first acquired the Eads Bridge, which was then the only Mississippi River railroad bridge entering St. Louis, and a hodgepodge of connecting tracks, switching yards, and terminal buildings, including the St. Louis Union Station.

The Merchants Bridge, a second railroad bridge into St. Louis was completed in 1890; the act of Congress authorizing its construction originally prohibited the Association from owning any stock in the new bridge company. After that restrictive provision was deleted a few years later, the Association quickly purchased majority control of the second bridge. In 1902, the

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[11] 224 U.S. 383 (1912).

[12] D. Reiffen & A. Kleit, Terminal Railroad Revisited: Foreclosure of an Essential Facility or Simple Horizontal Monopoly? (Bureau of Economics Working Paper No. 172, 1989).

Association won a take-over battle for the Wiggins Ferry Company, which could ferry 1200 railroad cars across the river daily; the Association later bought two smaller ferry operators. It appears that there were considerable barriers to entry into the ferry business; for one thing, the ferry lines that had been purchased by the Association owned much of the riverfront land on both sides of the Mississippi.

Under current merger standards, the authors of the working paper conclude, antitrust authorities almost certainly would have sought to block the mergers that resulted in that monopoly.[13] The Missouri attorney general did bring a suit seeking to dissolve the 1893 merger between the Association and the Merchants Bridge Company, but the Missouri Supreme Court ruled that the merger was legal under state law because the combination of the switching facilities owned by the merging firms resulted in important efficiencies. To the extent this is true, it is not clear that divestiture would have been an optimal remedy.

The decree of the United States Supreme Court in the Terminal Railroad case provided that the Association could avoid dissolution if it eliminated a special surcharge on freight shipments originating or terminating in St. Louis, admitted other railroads to membership in the Association, and served non-member railroads on equal terms. According to the authors of the working paper, the record indicates that the Association had in

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[13] Id. at 30.

fact served non-members on the same terms as members, although it clearly had the ability to deny access to its facilities or charge higher tolls to non-members.

Let me turn now from the 19th-century world of railroads and robber barons to a very 20th-century phenomenon: real estate multiple listing services. A multiple listing service, or "MLS," is an information clearinghouse that enables member real estate brokerage firms to exchange information on listed properties more easily. In most geographic markets, there is only one MLS, and the vast majority of real estate firms belong to their local MLS. Membership in the local MLS may be a practical necessity for real estate firms; firms that are denied access to the MLS often cannot compete effectively with member firms,[14] so an MLS may be an essential facility.

The Commission has approved several consent agreements with multiple listing services.[15] The orders in the MLS matters look quite different from the Donnelly order. Although Donnelly was not a classic essential facilities case, the Commission's order in Donnelly was a classic essential facilities order: Donnelly was ordered to list the flights of commuter airlines in exactly the same manner as it listed the flights of major interstate

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[14] See, e.g., Austin, Real Estate Boards and Multiple Listing Systems as Restraints of Trade, 20 Colum. L. Rev. 1325 (1970).

[15] Multiple Listing Service Mid County, Inc., Docket No. C-3227 (Apr. 20, 1988); Florence Multiple Listing Service, Inc., Docket No. C-3228 (Apr. 20, 1988); Orange County Board of Realtors, Inc., 106 F.T.C. 88 (1985); Multiple Listing Service of Greater Michigan City Area, Inc., 106 F.T.C. 95 (1985).

airlines. The order said nothing about what those listings should look like; it simply mandated equal treatment for all airlines.

The focus of the MLS complaints was not so much the exclusion of certain firms as it was the conditions for MLS membership, some of which were alleged to be anticompetitive. The MLS orders, unlike the Donnelly order, do not require that the MLS simply treat all applicants for membership equally. Instead, those orders prohibit certain membership requirements -- such as requirements that members not join any competing MLS and not solicit a property relisting until the existing listing agreement has expired -- that appear to be anticompetitive. In that sense, the MLS orders resemble the many Commission orders striking down professional association ethical code provisions that restrain advertising or impose other anticompetitive restrictions.

In contrast with the Donnelly order, the MLS orders clearly focus on injury to competition rather than injury to individual competitors. In his dissent in Fishman v. Wirtz,[16] Judge Easterbrook criticized the majority for confusing business torts and antitrust violations:

> Antitrust law condemns results harmful to consumers; it condemns bad means to the extent they have a tendency to bad results. Bad means that injure only business rivals -- that is to say, business torts -- are outside the scope of antitrust law.[17]

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[16] 807 F.2d 520 (1986).

[17] Id. at 564.

In Judge Easterbrook's view, Fishman involved a battle by two would-be monopolists, the outcome of which was unimportant to consumers: there was no reason to think that the quantity produced, the price charged, or the quality supplied depended on which side won. "[U]nless the plaintiff can make out a plausible case of consumers' injury, actual or potential, now or tomorrow," he concluded, "there is no antitrust problem."[18]

Private antitrust litigation sometimes benefits consumers generally, but the typical litigant is more concerned with benefitting himself. The Commission, however, is charged with a duty to act in the public interest. While we may not always act wisely, our intentions are good: we worry about how our actions will affect consumers and competition generally, not how they will affect one or a few competitors.

Perhaps that is the best argument in favor of the Commission continuing to handle cases involving essential facilities, which by their very nature invite more consideration of the plight of an excluded competitor than the effect of that exclusion on the public as a whole. Ideally, Commission review of essential facilities cases offers the best of both worlds: it is less costly than direct regulation of such facilities, and its focus is clearly on serving the public interest rather than promoting the interests of individual competitors. Even in those instances where direct regulation is preferable to antitrust enforcement, there may be a role for the Commission to play: we may be able

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18 Id. at 585.

to help the regulatory agency craft a program of regulation that does not burden competition unnecessarily.

Of course, it is always better to prevent problems if possible. When it comes to Terminal Railroad-type monopolies, an ounce of Section 7 enforcement may be worth a pound of essential facility regulation.

Thank you.