UNITED STATES FEDERAL TRADE COMMISSION

and

UNITED STATES DEPARTMENT OF JUSTICE

SHERMAN ACT SECTION 2 JOINT HEARING

BUSINESS TESTIMONY

TUESDAY, FEBRUARY 13, 2007

HELD AT:

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GRADUATE SCHOOL OF BUSINESS

EXECUTIVE CENTER - 450

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CHICAGO, ILLINOIS 60611

9:30 A.M. TO 4:00 P.M.

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APPEARANCES:

MODERATORS:

Morning Session:
JAIME TARONJI, JR.
Attorney, Policy Studies,
Federal Trade Commission
and
JOSEPH J. MATELIS, II
Attorney Advisor, Legal Policy Section
Antitrust Division, Department of Justice
and
WILLIAM COHEN
Deputy General Counsel for Policy Studies
Federal Trade Commission

PANELISTS:

Morning Session:
David Balto
Patrick Sheller
Ron Stern

APPEARANCES CONTINUED:

MODERATORS:

Afternoon Session:
JOSEPH J. MATELIS, II
Attorney Advisor, Legal Policy Section
Antitrust Division, Department of Justice
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KAREN GRIMM,
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Federal Trade Commission

PANELISTS:

Afternoon Session:
Sean Heather
Bruce Sewell
Bruce Wark

single-firm conduct under Section 2 of the Sherman Act. In particular, I would like to thank Dean Ted Snyder and the staff of

the world.

Our panelists this morning are David Balto for the Generic Pharmaceutical Association, Patrick Sheller from Kodak, and Ron Stern from G.E.

Our format this morning will be as follows. Each speaker will make a 20- to 25-minute presentation. We will then take a 15-minute break. After the break, we will reconvene and have a moderated discussion with our panelists.

These hearings in Chicago are an important component of the joint FTC and Antitrust Division hearings on single-firm conduct under Section 2 of the Sherman Act. They are designed to identify areas where single-firm conduct is causing competitive harm, areas where antitrust enforcement may be chilling desirable activity, and areas where additional guidance would be most valuable.

FTC chairman, Deborah Majoras made it clear at the opening session of these hearings that she wanted to hear from businesses, either through their executives

goal to obtain as much insight and real-world experience as possible from business representatives.

This is the second set of hearings that have specifically been devoted to obtaining testimony from company representatives and associations. The first set of business testimony hearings were in Berkeley, California on January 30th, 2007.

We look forward to hearing the panelists' comments and to the round-table discussion. I want to thank all of them for agreeing to participate in today's hearings. We know that it takes a lot of time to prepare for these hearings.

hearings we have held to date, we have benefitted from the insights of many highly-skilled antitrust attorneys and economists.

Today's hearing, as well as the sessions held last month in Berkeley, California, grew out of the belief that we could also learn much about single-firm conduct from businesses. Our panelists today are the people who help devise and implement business plans, aware that their firm's unilateral conduct may be challenged in private or government litigation and by foreign competition authorities. Their companies are also directly affected by the conduct of other firms.

Whether you've had occasion to view Section 2 of the Sherman Act as a sword directed at the heart of your business or as a shield protecting you from anticompetitive conduct of others, we look forward to hearing from you today.

On behalf of the Antitrust Division, I would also like to take this opportunity to thank the Gleacher Center and

the University of Chicago Graduate School of Business for hosting these hearings. Also on behalf of the Division, I'd like to thank David, Patrick, and Ron for volunteering your time today. We know that these hearings take a lot of effort, especially when traveling to Chicago in February. And we're very grateful for a valuable public service that you're rendering. Finally, I'd also like to thank Jim and Bill and their colleagues at the Federal Trade Commission for all their hard work organizing today's hearing. Thanks.

MR. TARONJI: Thank you, Joe.

Our first speaker this morning is David Balto. David Balto has practiced antitrust law for over 20 years, both at the Federal Trade Commission and the Antitrust Division. At the FTC he was the attorney adviser to Chairman Pitofsky and assistant director for policy and evaluation in the Bureau of Competition. He helped guide many of the FTC's pharmaceutical and health care enforcement efforts, including challenging patent settlement agreements.

David has written extensively

on antitrust and health care competition and is the vice chair of the ABA Antitrust Section Federal Civil Enforcement Committee. He graduated from Northeastern University School of Law and the University of Minnesota. And David is speaking today on behalf of the Generic Pharmaceutical Association. David.

MR. BALTO: Thank you, Joe. I want to express my privilege for -- to come here and testify in these hearings. And I want to mention on that that my remarks today are my own and don't necessarily reflect the remarks -- should not necessarily be attributed to the Generic Pharmaceutical Association or any of its members.

Let me set out the outlines of my testimony. I want to start off with one indisputable fact, hopefully indisputable

of single-firm conduct.

I'm then going to talk about two forms of anticompetitive conduct by branded pharmaceutical companies and how those forms of conduct should be analyzed, and then perhaps close with some suggestions. Let me begin with the indisputable.

Generic competition benefits every consumer in the United States. Generic drugs sell for about 70 percent less than branded drugs. They account for 56 percent of all prescriptions and less than 13 percent of all pharmaceutical expenditures.

The last time TEO studied this issue in 1994 they found that generic drugs saved consumers between 8 and $10 billion a year at a time when generic substitution was vastly lower than it is today.

Antitrust enforcement in the generic drug industry is essential. Let me put this into context. Today you can walk out of this hearing room and go to your local pharmacy and buy a generic form of Remeron, Relafen, Buspar, Taxol, Augmentin,

connotations when practiced by the monopolist.

Now, I think there are four factors in the pharmaceutical industry that should make people cautious about bright-line rules in this industry. First, pharmaceuticals are heavily regulated; and as my testimony sets forward, this provides a remarkable number of opportunities for engaging in what's been called by the FTC cheap exclusion.

Second, who is the buyer? Now, knowing who the buyer is is critical to defining markets and determining market power and also oftentimes to determine whether or not certain parties have standing. But in the pharmaceutical industry is the ultimate buyer the consumer, the insurance company, the pharmaceutical benefit manager, the physician who prescribes the drugs, or a combination of all of these?

Third, pharmaceuticals have high fixed costs but very low average variable costs. And so when my colleagues today go and talk about bright-line rules for

predatory pricing, those might not apply that well in a setting with that kind of cost structure.

Then finally, forms of distribution are complex. Pharmaceuticals are distributed through all these numerous different intermediaries, and not all distribution mechanisms are the same. Maybe in the questioning period we'll go and talk about distribution exclusivity cases where I can address some of these ideas.

Now, I want to talk today about two form -- fortunately through a combination of the FTC's and State Attorneys General enforcement actions, the FTC's advocacy to Congress, Congressional legislation, many of the recipe -- the recipe book for anticompetitive conduct by dominant pharmaceutical companies has basically been thrown out. But like all good cooks, the pharmaceutical companies have come up with new forms of anticompetitive conduct, and I wanted to talk about two of them today to illustrate the importance of a couple things, the importance of antitrust enforcement, the

which is used to lower cholesterol. It's am almost billion dollar drug. Impax and Teva were developing a generic alternative. Each time they were poised to enter, the branded pharmaceutical manufacturer made some small change to the product, thus preventing them from being able to enter. The last change was changing the product from a capsule version to a tablet version. The tablet version was supposedly superior because it didn't have to be taken with food.

But Abbott didn't just change the product. After the tablet formulation was approved, it stopped selling the Tricor capsules. It bought up all the excess Tricor capsules. And then there's this important register. It's called the National Drug Data File. And the only way you can get a generic drug into the market is if it's listed in the NDDF. And what Abbott did is it listed -- changed the code for Tricor capsules in the National Drug Data File to obsolete.

Anyway, so let's go to the litigation. Abbott and Teva sued, along with

a group of buyers of drugs. And the defendants basically say, you know, this is a product improvement. There is no role for antitrust here. There is a per se legal rule. In order to demonstrate a violation, they would have to show that quote: The innovator knew before introducing the improvement into the market that it was absolutely no better than the prior version, and that the only purpose of the innovation was to eliminate the complementary product of a rival. That was the standard articulated by Abbott.

And you know, there was case law that supported Abbott's position, though not in the pharmaceutical industry. Now, rather than adopting the rule of a per se legality, the Court went back to the test articulated by the D.C. Circuit in Microsoft which suggests a rule of reason balancing test. And it said the per se rule as proposed by the defendants presupposes an open market where the merits of any new product can be tested by unfettered consumer choice. But here, consumers were not

presented with a choice between the products. Instead, they eliminated that choice by removing the old formulations of the products.

Now, I know my colleagues on the panel, their hair is about to stand up at this point because what this Court has basically suggested is that there is a duty to deal. That a dominant firm in some sense has some kind of obligation, a duty to deal, with its rivals. How could that be? Well, let's see what the Court said.

It said, A co-monopolist is not free to take certain actions that a company in a competitive or even oligopolistic market may take because there is no market restraint on a monopolist's behavior, harkening back to Justice Scalia's idea that I mentioned before.

So in this case where the dominant firm went beyond a simple product innovation, but also created obstacles for the other firms to effectively enter the market, that was a violation.

Now, there's a similar case

in the E.U. and in Canada involving Astra Zeneca, the drug Lobec. In this case violations were found in both of those jurisdictions. In that case what happened was as the patents on the drug were expiring, Astra Zeneca filed for additional patents, but these were patents that really weren't used on improving the drug. These were just additional patents to create the additional obstacles. And again, antitrust violations were found.

The most interesting case here is a case that was just filed in the past year or so, and it involves the very well-known conversion of the drug Prilosec to Nexium as Prilosec was losing its patent protection. This again involved Astra Zeneca. This is something like a $4 billion-a-year drug.

In the alleged anticompetitive conduct it was said, up to 18 months before Astra Zeneca was about to lose exclusivity it stopped promoting the drug, and instead, started to make negative claims about the drug. Now, I don't know about you

start making negative claims about their drugs.

More important than just creating Nexium, they also effectively withdrew Prilosec from the market, so it was impossible for managed care organizations to go and sort of continue to contract for Prilosec.

And so when generic Prilosec was about to arise, there was no possibility for it to substitute for branded Prilosec.

And one of the most interesting issues and maybe something worth discussing later on is the fact, as alleged, that Nexium was no improvement on Prilosec.

Let's go on to the issue of petitioning and litigation. You know, one of the most important achievements of the Federal Trade Commission has been the focus on sham petitioning and the use of regulatory processes to create competitive harm. Probably the case in which they've brought the most consumer benefits was the Unocal case in which it attacked sham petitioning by Unocal before the California Resources Board

that costs consumers in California over $500 million annually.

Sham petitioning is a serious problem. As the FTC's recent staff report on the Noerr-Pennington Doctrine observed: One of the most effective ways for parties to acquire or maintain market power is through the abuse of governmental processes. The cost of the party engaging in such abuse is typically minimal, while the anticompetitive effects resulting from such abuse are often significant and durable.

Anticompetitive conduct through regulatory abuse can be especially pernicious if, God forbid, Kodak or GE were to engage in any kind of abusive conduct. If they exploited their dominant power, it

approval. That may be despite the fact that the FDA may have granted a tentative approval, that maybe despite the fact that similar petitions have already been filed. The brand strategy is just simply delay the generic drug from the market. And you can imagine when you're talking about drugs in which the amount of profits amount to 10 to $20 million a day, this could be a very attractive opportunity.

The FDA citizen petition process provides significant opportunities for deception. There are no requirements for proof of the accusations made in the petition. No requirements for certification of the accuracy of the information. There are no penalties for inaccurate or improper filings. There are no limits on the number of filings that may be filed. Some petitions contain little or no evidence or rely on obsolete, irrelevant, or erroneous information.

The FDA has even noted the fact that they've seen several examples of citizen petitions seemingly designed to delay

the approval of generic approval.

So let's look at the numbers. You know, if I wanted to make it to Wrigley Field this spring, if I wanted to join the Cubs for spring training, I'd want to have a pretty good batting average. Otherwise, they wouldn't look at me.

What's the batting average on citizen petitions? Since the Medicare Monitorization Act was passed in 2003, there have been 45 citizen petitions filed challenging the conduct trying to delay the entry of generic drugs. 45. 21 of these have been resolved. One has been resolved in the favor of the petitioner. One. 20 have been denied.

Now, if I'm batting at .05 percent, I'm not going to get much of a try-out at Wrigley Field this spring. None of the last-minute -- many of these petitions were filed within the four-month period prior -- half of them were filed in the four-month prior period to the entry of the drug. Did any of those succeed? None. Not one.

Well, how much do they delay

things? Those late-filed petitions delayed

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identified earlier can forestall competition.

The FTC, State Attorneys General, and private antitrust lawyers have played an important role in protecting pharmaceutical markets from artificial barriers to competition, and I hope these hearings keep Section 2 as a robust statute so that it can continue to be used to protect the interest of consumers and competitors in this vital market. Thank you.

(Applause)

MR. TARONJI: Thank you, David. Our next speaker is Patrick Sheller. Patrick is the chief compliance officer for Eastman Kodak Company. In that capacity he is responsible for Kodak's code of conduct

the so-called single-brand derivative aftermarket; the notion being that once a customer chooses to purchase an expensive item of capital equipment, they're now locked into that particular brand or manufacturer. Whether or not that manufacturer has market power in the primary market for photocopiers, for example, was determined to be irrelevant to the Supreme Court. The ITS case went back to the trial court on remand, and I'll speak more to the trial in a minute.

In 1994 Kodak challenged some aspects of the 1921 and 1954 consent decrees. We were successful in overturning the private label restriction and the prohibition on linking film with photo finishing sales, primarily because we were able to demonstrate to the District Court and to the Second Circuit that market conditions had changed

Finally, in 1996 the Ninth Circuit heard Kodak's appeal of the jury verdict in the ITS case. The jury found that we had engaged in an unlawful refusal to deal by refusing to provide patented and copyrighted parts and copyrighted diagnostic software and manuals to ISO's.

The key ruling in that case, for purposes of my remarks today, was that an IP owner faces restrictions on its ability to refuse to deal with ISOs by refusing to license its IP.

The Ninth Circuit picked up on the First Circuit's decision in the Data General case in holding that there is a presumption in favor of an IP owner, that it has a legitimate business justification for refusing to deal with a rival. But that presumption can be overcome by evidence that the IP owner had an anticompetitive intent. The 9th circuit's ruling essentially opens the door to ISO's to come up with evidence in the form of internal documents showing that the IP owner was trying to keep out competition through its decision to refuse to deal.

Now, the history of Kodak's experience with Section 2 parallels in many ways the evolution of our company, our technology, and our business model. Beginning in the 1880's and through the 70's, the focus of our business was on consumables. We primarily sold film

The focus of our business going forward is going to be on selling solutions. Solution selling is very common in the digital world where companies will bundle a portfolio of offerings that include hardware, software, consumables, consulting services, and aftermarket service into a single price to sell to customers who demand an end-to-end solution.

Our sales focus going forward will be on digital products such as photo printer kiosks, image centers. We announced last week the introduction of a new line of consumer ink-jet printers, which means Kodak will now be competing in a new market. We will also offer Digital cameras, media ink, and so forth.

Elements of the old business models still remao-2 412.9800 TD(13)TjET1.00000 0.00000

factors to our new digital model are, first of all, that we rapidly innovate and develop new technology to commercialize new products. Digital companies constantly introduce new versions of their products. We have to keep pace in this fast-moving environment. And in that sense, intellectual property has become increasingly important to Kodak.

We need to be able to protect our research and development investments, wherever possible, through patents and copyrights, and we need to be able to protect these assets in a way that doesn't offend the antitrust laws.

One of our key strategies going forward is to monetize our intellectual properties. Kodak has, for the last several years, entered into numerous licensing agreements with other digital players in the industry, and we need to be able to go about that licensing activity without fear of antitrust concerns, as I'll talk about in a few minutes.

And finally, as I mentioned,

solution selling is critical to our success in the digital world. A good example is our graphic communications business which sells graphic solutions to printing firms.

no coherent standard with which to evaluate bundled pricing under the LePage's decision.

We would submit there were better alternative paths that the Third Circuit could have taken in evaluating the case against 3M. The Eighth Circuit's decision in Concord Boat applied the Brooke Group decision by the Supreme Court to find that as long as single-product discounts are above cost, they should not be considered exclusionary under Section 2.

It would have also been helpful if the court had given some thought to the Ortho Diagnostic's Systems case by the Southern District of New York where the court articulated its analysis of the alleged bundling by asking whether an equally efficient competitor to the monopolist could profitably match the bundled

non-monopoly product, we now have to deal with a precedent that articulates no coherent standard such that bundled discounts now come under scrutiny. As I said before, bundling is very important to our

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As a result, we have a clear split among the circuits that has created a great deal of uncertainty on the part of the IP owners and companies that provide aftermarket service.

Where does the uncertainty in these two areas leave Kodak and other companies? First, if we're successful with our digital strategy, and we're able to achieve a leading market position in some of the new digital markets where we participate, our ability to offer competitive bundled pricing could be constrained by the LePage's decision. As I said, bundled pricing is really the essence of solution selling.

Second, notwithstanding a lack of market power in the primary equipment markets in which we compete, we still face potential challenges by ISO's that can allege that Kodak dominates a single brand aftermarket for a particular line of equipment. Such ISOs will try to require us to license or sell our valuable intellectual property.

Let me offer a few examples of the dilemmas these ambiguities can create,

hand in the marketplace.

Could we, in licensing to other digital camera sellers, bundle Kodak software that allows customers to view their images on a PC?

We offer an on-line photo service where you can upload your photos and order prints or order prints on different items like T-shirts and coffee mugs. This is called the Kodak Easy Share Gallery. The question arises whether in the event we were to gain a leading market position with our Kodak Photo Gallery, we could say to our customers who agree to store a fixed number of images on our site that they will get a discount on their prints?

And finally with respect to our graphics business, which I mentioned is very much focused trying to meet the end to end work-flow demands of our customers, are there antitrust concerns with our selling graphic communications equipment, software, consumables, consulting services, and aftermarket services as a bundle? Should it make a difference that our customers demand

such solution sales?

These are some of the issues that we grapple with in light of the uncertainty under Section 2 that I've outlined, and I'll look forward to further discussion on these and other issues when we get to the questioning period.

(Applause)

MR. TARONJI: Thank you, Patrick. Our next speaker is Ron Stern. Ron is the vice president and senior competition counsel for the General Electric Company. Ron received his AB from Brown University and his law degree from Harvard.

He clerked for Judge Harold Leventhal of the U.S. Court of Appeals for the D.C. Circuit and for Justice Potter Stewart of the U.S. Supreme Court. He was in private practice with Hughes, Hubbard & Reid and was a partner with Arnold & Porter.

In addition, he was the special assistant to the Assistant Attorney General for the Criminal Division of the U.S. Department of Justice. Ron.

MR. STERN: I'd like to

begin by thanking the Antitrust Division and the Federal Trust Commission for holding these hearings and for providing me and others with the opportunity to address important issues relating to the application of the antitrust laws to single-firm conduct.

In particular, I would like to thank the staff at both agencies who have organized these hearings and put in the hard work required to make them a success.

I also want to make clear at the outset that the views and opinions that I am providing today and that are in the written slides are my own personal views and not those of the General Electric Company or of other General Electric officials.

Let me begin with an overview. I want to agree with the heads of the two agencies that are hosting these hearings, the Assistant Attorney General and the Chairman of the Federal Trade Commission, that it is important to have clear, administrable, and objective rules. This is a key requirement, something that's really at the heart of these hearings.

It's important for business to avoid chilling procompetitive conduct. It's also important for consumers. It's important to help avoid inadvertent violations and disputes and investigations that end up wasting company time and resources as well as the time and resources of the agencies.

And finally, it's important to reduce the cost of developing and implementing business plans to foster competition in the marketplace.

Now increasingly, as the economy globalizes, it's not sufficient that the U.S. rules are clear. The rules adopted by other jurisdictions will, of course, affect U.S. commerce. And I do not believe that it is surprising or coincidental that the United States, European Commission, and the International Competition Network, an organization formed by, I believe, more than 100 competition authorities around the world, are all addressing the issue of competition standards for single-firm conduct at this time.

In a global economy this is a global issue, not just a United States issue; and that's important, particularly for companies such as mine, that operate in a number of global markets.

What I'd like to do today is walk through from a counseling perspective which is a perspective, I see every day, and look at areas that could be clarified in Section 2.

First, the issue is what kind of rule governs. Is your conduct unilateral, single-firm conduct, or is it multi-firm conduct? Is it something that Section 1 governs or Article 81 in Europe?

Or is it something that Section 2 governs as single-firm conduct or Article 82 in Europe?

The next issue is whether there is a threshold solution or a threshold screen that makes you comfortable that the conduct doesn't violate the law? And one important screen under the U.S. law is the requirement of monopoly power.

If you can be sure that your

of potential consequences, from injunctive relief to fines, not in the U.S., but in some jurisdictions, to treble damage awards, legal fees, and the like.

So what I'd like to do is continue to walk through the issues. One issue that reinforces the concern that I'd just like to touch upon is the fact that jury instructions in the Section 2 area are often particularly problematic. I've just set some examples up on the screen, but basically they involve very general types of words. Is the conduct wrongful? Did one buy more logs than were necessary or pay a higher price than was necessary? Did the impetition from the merits? competition on the merits?

beginning. Do you know whether you're in the single-firm conduct area? We obviously have the Copperweld decision and clear law that if you're a company and you're dealing with a wholly-owned subsidiary, you're one entity, and you know that you can't violate Sherman Act Section 1 by having an agreement in restraint of trade because you don't have two parties. You just have one.

The problem is under Copperweld the application is unclear. The law in the lower courts is divided as to where the line is when you're dealing with non-wholly-owned subsidiaries.

And one important thing that the government could do is reinstate the guidance that existed in 1988 with the antitrust enforcement guidelines for international operations. I've included that in the slides.

And the clear guidance that was given then, I think, would be important to reinstate it, is that whenever you have more than 50 percent of the voting securities of a company owned by its parent or its

sister company, that whole family of companies is one economic entity and is subject only to Section 2, the single-firm conduct section, and not Section 1. That's one area in which I think clarity could be added.

Now, if we move beyond, the next issue is trying to identify whether your company in the particular situation that you're facing is subject to Section 2. And the first element of Section 2 is having monopoly power. The second element relates to the conduct. Is there a willful acquisition or maintenance of that power which is often referred to as engaging in exclusionary conduct.

Now, under United States law there is a pretty helpful screen. You have to have the power to control market price. And in bidding markets, it's clear that if there are other credible competitors, you generally don't have the power to control market prices, even if you have a very large share.

The case law gives some very

helpful general rules of thumb. If you have more than a 70 percent share, you have to look at all of the other factors, but you at least know that you're in a danger zone.

If you have less than a 50 percent share under the U.S. case law, it's very unlikely that you have to worry about whether your conduct could be categorized as exclusionary.

Some people point to the fact

about.

The first is the issue that's been discussed that Patrick talked about, the treatment of aftermarkets. And the second are non-U.S. issues, that there are lower dominance thresholds outside the U.S. And indeed, there is the curious concept of collective dominance, at least curious to a U.S. antitrust lawyer outside the U.S., so let me turn to those.

First I'd like to turn to aftermarkets. As Patrick mentioned, this comes from the Kodak case. There the Supreme Court held that there was the potential, not that it was always the case, but the potential for there to be a single brand parts and service market, even where the company had a modest percentage and had no monopoly power in the interband equipment market. Here, Kodak had less than 25 percent, clearly in the safe harbor of the interband photocopier market. Photocopiers are often referred to as Xerox machines, not Kodak machines. That's for a reason. They didn't have market power. But they had a

very large share of an intrabrand parts and service market for Kodak copiers.

Now, post-Kodak, there have been a number of court cases interpreting Kodak, and they have limited Kodak's application in most circuits to a situation in which there has been a change of policy with respect to aftermarket sales of parts or service. That however has not been uniform. The Ninth Circuit is sort of an outlier.

All in all, what this does, I believe, is create very significant problems. All suppliers of capital goods are exposed today to the notion of having to worry about whether or not they fall under Section 2 when they deal with parts and services for the products that they sell.

And somewhat ironically, if you have a modest market share, you're one of the also-rans in the interbrand equipment market, you may have a higher share of your single-brand parts and service market for the very simple reason that third parties tend to focus on the most successful installed base products to develop non-OEM parts and non-OEM

unnecessary and unsound.

And the Department of Justice thought it was unsound in its amicus brief in Kodak.

So I think what should be clarified here is this notion of single-brand

around the world is that generally, the presumption of dominance, which is essentially the non-U.S. equivalent of monopoly power, is set at a 33 percent to 50 percent level. Now, that's below what is essentially the U.S. safe harbor level.

And what it does, of course, in a global marketplace is tend to expose a much larger number of leading firms to the potential that you have to worry about whether your conduct is going to be characterized in these regimes as abusive, or if you use the United States approach, as exclusionary.

Now, there's one good thing. There's also a trend towards taking a behavioral approach, which is looking at the ability to set market prices, the same approach taken under Section 2 in the U.S., rather than a purely structural presumption based on market shares.

I'd like to turn to another problem that I think is one that should be addressed. It's not a huge problem today, but it's the concept of collective dominance.

The European Commission Article 82 discussion paper talks about the fact that there can be collective dominance simply in a oligopolistic situation. You don't have to have an agreement with your competitors as long as a small number of firms control a large combined share of the marketplace. Then they can act in a way that supposedly would abuse their collective dominant position.

My sense is that this has never been applied, as far as I know, but it raises a real counseling concern. What are you supposed to do if your rival raises price? If all the other rivals in an oligopoly do what they often do, and that is match the price increase, have you then committed and abouse of collective dominance?

If you have a policy of having exclusive distributors and other firms follow that policy because it's efficient, have you violated collective dominance? It's very hard to figure out how to counsel. This is something that again, isn't a real-world problem today, but I think

situations it seems to me there should be a per se lawful rule.

Now what the case law has evolved in the Trinko decision is a notion that the Aspen Skiing case is the outer limits. And the Aspen Skiing case involved a refusal to continue to deal after there had been a voluntary cooperation with the plaintiff.

And the problem that that approach creates is obviously it causes people to be incentivized not to deal in the first place. The concern would be if that's the law, you would never have had the all-mountain pass in Aspen in the first place because the party with the three mountains would have known not to enter into the cooperation because it could have been accused of violating Section 2 should it have wanted to reverse course later.

This creates perverse incentives, and there is of course the entractible problem of remedies. Courts simply aren't set up to deal with the situation of how does one decide what the

real need for clarity.

So what I want to do is start with just asking some questions and suggesting some responses that might create clarity. The first one is can we identify types of market situations where there just isn't likely to be a problem.

And I highlight one of them, Professor Barry Nalebuff, someone who has written extensively about bundling, suggested that in certain circumstances, at least from an economic theory point of view, it could create issues. But he's been very clear that that only really happens in a market situation in which the seller sets one price for all buyers of the product. And it doesn't happen in a situation in which there is bidding on an individual customer basis or negotiation on an individual customer basis.

If in fact that's a valid distinction, having that kind of clarification would be very important. It certainly would be important for my client, which generally engages in negotiated sales of products rather than consumer products where

for discussion is that these cases should generally fall into one of two categories. They ought to either be analyzed as tying, or they should be analyzed as predatory pricing. Again, Professor Nalebuff had talked about an example in his testimony in which he said well, predatory pricing really doesn't apply in some of these kinds of scenarios because there can be no-cost bundling. And his hypothetical was one in which you took the monopoly product and you raised the price of the monopoly product well above the monopoly price, and then you bundled using the monopoly price as the price of the monopoly good in the bundle, and then you priced in the competitive product.

And he said in that circumstance, well, no one would actually take the monopoly product separately. Well, at least from my legal standpoint, most courts would treat that situation in which the second product wasn't economically available as a tying situation, in which you were simply not selling the monopoly product unless you also bought the other product in

the bundle. And in that situation, particularly where you're involved with a second market, you should be able to deal with the screen of attempted monopolization. You also of course can solve the problem by making sure that the separate price is a realistic price so that you avoid tying.

It seems to me then the other cases are situations in which you really are giving a discount off of the monopoly price in an attempt to assist in the sale of the competitive product.

And that sort of situation, if that's what's really going on, you do have discounting or loss on what you could otherwise sell the monopoly product for. In that sort of situation then the issue should be a predatory pricing analysis.

Now one approach that

approach.

It's a highly stylized situation in which there is no competitor. There is an absolute monopolist, and there is no one else selling Product A.

When there are fringe sellers of Product A, those fringe sellers can help undermine the bundled price for the package.

There may also be situations in which there is a bundle with two competitive products, and it may be that the plaintiff can only sell one of those, but some other party can sell the second competitive product. They can team together and provide their own bundled discount. Or particularly, when you've got sophisticated customers, the customers can search the marketplace and provide their own added ala

been achievable just by discounting the branded tape that was clearly sold at a large margin above cost. But if we're assuming it's one market and you've lowered the price of the branded tape, presumably that would have applied the same pressure to LePage's the generic tape. Yet that clearly would have been appropriate under Brooke Group. You're not required to charge the monopoly price. As long as you're just giving discounts on a single product, that would be lawful. Would that have had the same effect in LePage's?

And then I think finally, an important part of this discussion -- and I think it goes broader than that case. This case is an example -- is what is achieved by the rule. What would have been accomplished? Would it have led to less discounting by 3M? How do you deal with situations in which you have leading or successful firms that you want to compete on price?

If the only rule is that you must discount on a product-by-product basis, that may result essentially in less price competition and may harm consumers because,

I think all unconditional unilateral refusals to deal should be treated as per lawful, whether they involve intellectual property or not. That should be clarified. That should be advocated to the courts. That should be advocated in international settings.

There are a number of ways I suggested in which the treatment of bundled discounts could be clarified. And finally, this idea of customer-initiated exclusive, I think a very simple, straightforward, helpful, practical clarification.

Then I just want to underscore I think it's very important that we take the step of clarifying the U.S. law both at the Agency level for their enforcement discretion to go the next step which both agencies have done an excellent job of moving the agenda in the courts through amicus brief process and getting a number of key clarifications. I hope there are more at this term with the cases that are pending.

And then finally, continuing

to be active in bilateral discussions with other competition authorities and being a leader in the international competition network. Thank you.

(Applause)

MR. TARONJI: Thank you, Ron. We're going to take a 15-minute break and be back here at 11:15.

(Break taken)

MR. TARONJI: Well, thank you. The first thing I would like to do is offer each of the presenters an opportunity to comment on what they've heard from the other panelists. Let me start in order. David.

MR. BALTO: You know, it's hard for me to comment on the terrific presentations of these two speakers. You know, generic -- let me make a simple point. Generic drug companies are almost never dominant. We're in like the most intensely competitive market. In any generic drug category you're certainly going to have five, six, seven competitors. Prices quickly computed down to marginal costs. So the

headaches my colleagues have to live with I don't really have to deal with.

I do have a little concern about one suggestion that Ron made, however. The idea that we should have a safe harbor for customer-instigated exclusive dealing. I just know from my experience in the enforcement agencies, you know, you'd always walk in there, and oh, you would have anticompetitive conduct investigations. And the parties would say, oh, customers really wanted this.

Well, you know, when you actually sat down and were able to go and interview the customers you found out that, you know, they wanted it only because their arm was being twisted in a significant fashion.

And also sometimes the interests of customers aren't really in confluence with the interests of consumers. And I think one of the kinds of practices that a lot of the previous speakers at these hearings have identified, some of the kinds of practices they've identified are

pharmaceutical area.

It just struck me that it was a situation in which perhaps it called out for regulatory reform to address many of the issues that David was talking about rather than having the antitrust laws and the court bear the entire burden in this area.

It is one in which, of course, there are large expenditures made and large amounts of money at risk when the patent protections go off. And obviously that causes people to look for opportunities to continue to make the profits during the protected time period. And again, regulatory reforms may be a better solution.

With respect to his sham petitioning point, it seems to me again this is an area simply in which clear rules would be important. I don't think anyone would

exception to that exemption, then it seems to me it needs to be a clear one so that people can counsel and take advantage of the governmental processes and the First Amendment in an appropriate way and keep one's clients out of a situation in which they expose themselves to government investigations and treble damages lawsuits.

And to his other point, if I could take a moment on the customer-driven or customer-initiated exclusives, I take his point that there can be seller-initiated customer demand, and that's a fact issue. But it's sometimes very clear if a customer puts out an RFP and there haven't been any private discussions, that it's customer initiated and that's the way this will happen, I believe in a number of contexts. And if in fact you can -- you know, a seller tries to undermine the process by promoting or encouraging or incentivizing the customer to make such a request, you know, I think that can be addressed and dealt with.

MR. TARONJI: I'm going to start off with some general questions, then

we'll move to some of the conduct-specific questions that we talked about. And I'd like to talk about counseling.

As a person who has given antitrust advice on the type of business conduct your company can or cannot engage in, have you found that there are specific types of conduct where the state of jurisprudence is such that your legal advice is either one, particularly easy to give and apply; or two, particularly difficult to give and apply? Let me start with you Ron, and then I'll go with Patrick.

MR. STERN: Great. I'll be brief because that's mostly what I talked about.

It seems to me in the U.S. it's not difficult to apply the monopoly power threshold element these days. At least I haven't found it inordinately difficult. In tying, it's pretty easy to counsel as to when you are or are not engaged in tying. You have some other issues, if you are engaged in tying, to evaluate whether the conduct is exclusionary or not. And as I

mentioned in predatory pricing, I think there's some pretty clear guidance.

The difficult areas are the ones I mentioned regarding bundled discounts, refusals to deal, and the thorny problem of aftermarkets. So that would be my list.

MR. TARONJI: Okay. Patrick.

MR. SHELLER: I would echo what Ron said. You know, we don't seem to have too much difficulty indentifying the market monopoly power threshold, in the U.S. anyways. That becomes more of a challenge when we counsel clients outside the U.S.

Tying, as I said in my remarks, used to be an easier area in which to advise. But now, as I said, I think the line between tying and bundling is blurred because of the LePage's case. So today we have a have a lesser degree of confidence in couseling on tying arrangements.

Exclusive dealing, predatory pricing, I think the standards in those areas are fairly well established by the courts and by the agencies.

want to.

How do businesses such as yours respond to variations among different countries' competition laws with regard to single-firm conduct? Specifically, do international businesses decentralize decision making on business conduct to adapt to a foreign jurisdiction's competition laws?

Patrick, from Kodak's standpoint as a chief compliance officer and ensuring that Kodak is complying with all laws in all jurisdictions where you operate, how do you make those decisions where the standards may very well be different from one jurisdiction to the next?

MR. SHELLER: Well, we're definitely in the decentralized model. We have in-house counsel in most of the major markets around the world. So we rely very heavily on their advice.

However, there are circumstances where a business client may at the worldwide level be considering a program that, at least based on our limited knowledge of the

varies. There are a number of businesses we're in that are truly global businesses where you really need to counsel on a global basis rather than individualize.

The customers may be in different jurisdictions, but it's probably a global market, and you really can't go through the time and effort to try to figure out about extra-territorial application of the various laws.

So you try to counsel to sort of an international standard, always I think being concerned about the U.S. being necessary, because of the unique treble damage exposure and litigation costs in the U.S. But not sufficient, because you really want to make sure that you're meeting any more restrictive requirements in other areas.

If we had it, which we do, businesses that operate much more locally, and their conduct clearly is only going to affect a particular jurisdiction, you can be confident of that, then you can get more localized advice about the actions that will just affect that jurisdiction with a key

sort of comfortable, clear, safe harbor zone. And only if that creates real problems with achieving what you think is a legitimate business objective, are you able to spend the extra time and effort to see if you can design something that's more complicated.

So I think the concern that I was trying to express about the need to address this globally is that U.S. legal clarity at least in a number of areas, could be overridden by a lack of clarity or by overly restrictive rules outside the U.S. and the harm could come to U.S. consumers as well as those in other areas.

MR. MATELIS: Do you have anything to add, Patrick?

MR. SHELLER: We also take a slightly different approach which is to start with analyzing proposed plans under the U.S. standard. And assuming that we can give the green light from a U.S. antitrust perspective, then the next step would would be to look at whether there are nuances under European law that might create a problem. Then we'd seek advice

from our European counsel on those particular aspects.

And you know, increasingly now we'll look at some of the bigger markets and their antitrust enforcement. Ron spoke a little bit about the anti-monopoly law in China. We'll be keeping a close eye on developments there. And as that unfolds, it will be an important area that we'll focus on in our antitrust counseling.

But as the starting point, we typically begin with the U.S. standards.

MR. MATELIS: I have a question about clear rules. Ron and Patrick, in your remarks you both stressed the virtues, from your perspective, of clear rules in the Section 2 context.

David, in your remarks you sounded a provocative cautionary note that maybe clear rules have some drawbacks. And I'd just like to get all of your perspectives again on a very basic question. What are the pros and cons that policy makers and courts should be thinking about when articulating rules? Maybe we could start

can draw brighter lines for the client.

Second, I think it's important because it helps to make the antitrust laws appear more serious to business clients. If a business client is told that there's no real clear legal standard in the area where you're proposing a particular marketing plan, but here's some of the factors that we might consider, their reaction is likely to be: we might as well take the risk then. And so I think setting out clear rules helps business people to follow the antitrust laws.

I would, however, note a caution that safe harbors in the form of guidelines can be can be helpful, but they can also in some ways be unhelpful. And I'll give as an example the European block exemption on technology transfers and some of the safe harbors that are built into that exemption relating to market share. The market share thresholds that the Commission uses are very low so that almost any transaction you would consider in the IP area is going to be outside of the

they're going to apply them. And that's really what I think we're searching for.

And I think as my talk indicated, I'm happy to have them addressed in little half steps that do things that seem perhaps unimportant to some but are important in the real world. I think those steps are important and should be taken and not taken for granted.

And secondly, I agree very much with Patrick's point. People need to look at guidance that's meaningful. Safe harbors that do nothing to clarify the situation because they only exist in situations in which you never anywhere have monopoly power are useless. It doesn't really help you. But meaningful safe harbors and ones that are understood not to define the line between legal and illegal, but to simply define and clarify what is clearly legal and not questionable are very important.

MR. COHEN: Let me just return to David because you've for a second time referred to your thought that relying on

that there is increasingly interesting economic literature that uses -- that talks about the use of predation, the use of above-cost price -- of certain pricing strategies to create a reputation for predation and how that kind of predation can be anticompetitive. And you know, I think that's something that I know the courts and the agencies need to explore further.

MR. STERN: Can I just comment just for a second?

MR. TARONJI: Go ahead.

MR. STERN: I'm sure the economists who have participated in these hearings or will participate in later hearings or comment at the two hearings will know much better than I do.

But it seems to me at least it's a bit simple to say because variable costs are low and fixed costs are high that that standard doesn't work. It seems to me in that context what it really means is that there's very little likelihood of exit because people are committed in the market and they've sunk their costs. And in that

situation it's not clear how you end up with recoupment or whether you really have a problem.

And I don't purport to have the answer, but it seems to me it's a bit too facile to simply suggest that because average variable costs are low that the standard shouldn't be used.

MR. BALTO: Let me just mention an area that I've written on and that the FTC is currently studying. That's the issue of authorized generics, which I deliberately kept out of my testimony because there's a fair amount written about this.

An authorized generic is an arrangement between a branded pharmaceutical company that they enter into with another generic company to promote the entry of a second generic just prior to or immediately with the entry of the legitimate generic company. In other words, it's mother one of those situations where the generic is placed into the market it plans to -- you know, it plans to enter. And under the FDA regulations there's is six-month period of

exclusivity, which is the vast majority of the profits that a generic company makes when it enters into a generic market. And I've written about how this sort of strategy of, you know, making a deal with still another generic company to enter at the time of the legitimate generic's entry can be a strategy of predation. All the pricing is above cost. I think the pricing is meaningless.

But what's important about it is that what you're doing there is sending a signal to the generic firm that it's -- you know, if you plan to enter my market, you can expect the rug to be pulled out from under you, and you're not going to get the reward you're expecting to get.

And I think it's much more interesting to look at it from a certain strategic perspective.

MR. TARONJI: As you know, antitrust lawyers and judges are battling over how much weight to give to business documents, from strategic plans to e-mails and sales and marketing personnel.

What consideration should

out of it than I think they should.

But it does, to be clear and sort of to finish the thought, the general notion is that a customer will not go out and seek, you know, this kind of winner-take-all situation unless the customer thinks it's going to benefit by it.

In general, since the law is trying to promote customer welfare, the customer presumably would think it had enough competition and that by putting its demand out to this kind of winner-take-all bid that it wasn't changing the structure of the marketplace to its long-term detriment.

MR. TARONJI: Well, I want to make sure that with the remaining time we have the opportunity to cover some of the substantive conduct issues. And let me go to bundle discounts.

Does market share provide a useful screening mechanism for assessing loyalty discounts? And then I've got some subsets, so let me ask all of them and then you can comment on all of them.

Could we state a useful safe harbor based on market share; and if so, what

should that share be?

MR. SHELLER: Let me address the question on loyalty discounts, which I distinguish from bundling in some respects. I think loyalty discounts can be an issue under Section 2 if they're really equivalent to exclusive dealing. If a customer is given a significant discount if they buy 100 percent of their needs from the dominant supplier, then I would agree with the view that the European Commission takes: that this is tantamount to an exclusive dealing arrangement.

Therefore, market share thresholds could be important. 100 percent exclusivity is obviously a good indication that you've got exclusive dealing. Whereas, if the supplier through a loyalty discount tied up say 70 percent of the market or 60 percent of the market, then you're less likely to have competitive harm. There would still be opportunities for rivals to place their products with that particular customer as well as other customers.

MR. STERN: I guess my

reaction is that the term loyalty discounts encompasses so many different kinds of pricing practices and so many different situations that I would be hesitant to provide one market share test to address it. You know, just -- Patrick had mentioned the European Commission. In their Article 82 discussion paper they, I think, appropriately draw a distinction between a situation in

above cost, in which case the loyalty discount wouldn't be a problem.

For these hearings, I went back and read some cases I'd read before the Concord Boat case. And in that situation it seemed important to

MR. BALTO: Well, you know,

Densply and Microsoft and in LePage's.

You know, from a business's perspective, how do you sort of look at that?

MR. STERN: Well, I'll step up to that one. It seems to me it was the comment I was trying to make when I was asking some questions about 3M LePage's.

I think the most difficult area to counsel in, just because I think the law isn't very clear and helpful, and the jury instructions aren't very helpful is a situation in which you are clearly in a category where you have monopoly power. You meet that threshold. You're taking conduct that either involves exclusive dealing or some other type of conduct that the law can characterize as being exclusionary, and then the question, as I think I mentioned is, well, what sort of impact does that have ton9xbestion, as I think

act differently in some sort of way. That notion is reflected in the European community law with respect to some special responsibility, and some of the older case law affirms they're deemed to be dominant.

someone or not, because they give you perverse incentives at the end of the day.

MR. SHELLER: I think the market share test has limited value. I mean, it's a good starting point in which to advise clients. But what I tend to look at more often are other factors like whether this particular business has the ability to control prices in the market.

I'm thinking about a specific example of a business that I've advised at Kodak which is considered to have a high market share for a particular segment. But I know from experience in working with the business, that if they were to raise their prices by five percent, we'd see an influx of customers turning to competing suppliers. So in that sense I don't think the market share that's attributed to that business is a valuable indicator of market power.

And the other thing is the point that I made in my remarks which is that although you may have businesses in

Kodak's world which are beginning to lose share to other technologies, you've got to take those technologies into consideration in determining whether you've got a Section 2 case or not and whether those technologies ought to be included in the market.

MR. STERN: And just to add to Patrick's point, because I think it does a good job of illustrating one of the earlier questions about clear rules. I think it's -- the clear rule about the ability to control market prices, that may not sound as clear, but I think antitrust lawyers and clients can work off of that kind of rule versus one that had some hard and fast market share threshold as if that were a clear rule.

First, I think it's not a thoughtful one, as I mentioned, to have a hard and fast market share threshold. And

about one's ability to control market prices, it seems to me, is one you can apply in a market context and give -- be fairly comfortable about giving advice. And that's why I think it's important in the global context that people move more towards this kind of behavioral approach rather than a structural approach.

MR. TARONJI: Let me end on one question dealing with misleading and deceptive conduct.

Do you agree that if tortious conduct can be the subject of other causes of action or regulated under other regimes such as Food and Drug Administration, it should also be the subject of antitrust causes of action? I figured David had a strong feeling about that one.

MR. BALTO: Yeah, absolutely. If something independently violates the antitrust laws, that's fine. We should realize that -- I appreciate Ron's comments about my testimony. The regulatory process moves -- that these may be regulatory problems. The regulatory process moves

slowly and amending it is very difficult.

Antitrust enforcement plays a vital role in sort of telling people where there are problem areas. And part of -- you know, what I'd like to do is show you -- you know, part of what we do is -- what people do as enforcers is raise attention to things.

There's a recent court decision involving the drug DBABP which is used by tens of thousands of consumers, and there was a sham petitioning claim. And the sham petitioning claim was dismissed with seven words. That's all the district court judge said about the sham petitioning claim.

You know, part of this is having enforcement agencies pay attention to these types of issues, I think, affects behavior of the businesses involved and reduces the likelihood that they engage in deceptive and sham conduct.

MR. SHELLER: I would be very reluctant to apply a rule where the alleged predatory conduct, if it meets the standard of some state law violation, ought to be the basis of a Section 2

the devices for the agencies as they look at Section 2 enforcement. And I think this is a point that all three of us would agree on.

The role of the agencies in filing amicus briefs, not just before the Supreme Court, but in lower courts, in district court cases is tremendously

by sound economic and legal principles.

MR. TARONJI: Any of you want to have a final word?

MR. SHELLER: I would like to endorse David's remarks and just add the following. The agencies, and I'm going to again focus on the two areas of concern for Kodak -- the bundling area and the intellectual property rights -- had an opportunity to urge the Supreme Court to take up a case and really settle the law in that area, LePage's and then the Xerox case. In both cases the agencies took the view that maybe those issues weren't yet ripe for the Supreme Court to consider.

I would suggest that you be very clear in your advice to the Supreme Court in the future when the time is right to take those issues up. We would certainly appreciate that. And it would provide a lot of helpful guidance to the business community.

MR. TARONJI: Great. Ron, any final comments?

MR. STERN: Nothing other than to thank you and the few hardy souls who actually made it today for joining us.

MR. TARONJI: Please join me in a round of applause for our panelists.

(Applause)

MR. TARONJI: And we will reconvene at 1:30 for our second panel.

(At 12:00 noon a luncheon recess was taken until 1:30 p.m.)

AFTERNOON SESSION

reconvene at 1:30 for our second panel.

ask questions or make comments during the hearing. Thank you.

Before introducing our speakers this afternoon, I would like to first thank the University of Chicago's Graduate School of Business for hosting these joint FTC/DOJ hearings to solicit testimony on single-firm conduct. In particular, I would like to thank Dean Ted Snyder and the staff of the Gleacher Center for offering us their facilities and for making the necessary arrangements for us to hold these hearings here.

And finally, I would like to thank my FTC and Justice Department colleagues as well as the FTC's Midwest regional office in Chicago who have worked very hard to put these hearings together.

We are honored this afternoon to have a distinguished group of panelists from the business community. Our panelists this afternoon are first Sean Heather from the U.S. Chamber of Commerce, Bruce Sewell from Intel Corporation, and Bruce Wark from American Airlines. Sean, I will note, is

standing in at the last moment for Stan Anderson who was unable to be with us.

Our format this afternoon will be as follows. Each speaker will make a 20- to 25-minute presentation. We will then take a 15-minute break. And after the break we will reconvene and have a moderated discussion with our panelists.

As Jim said at our morning session, these hearings in Chicago are an extremely important component of the joint FTC and Antitrust Division hearings on single-firm conduct under Section 2.

Over the past eight months we have held hearings in Washington D.C. primarily focused on specific types of

part focused on specific types of conduct and have relied most heavily on speakers from academia and the private bar.

Our sessions today are somewhat different. They are designed to provide a forum for businesses to tell us what particular Section 2 issues are of concern to them, and to suggest ways in which we at the FTC and the Antitrust Division may be better able to address those issues and

Thanks.

MS. GRIMM: Our first speaker this afternoon is Sean Heather. Sean is with

largest business federation, representing more than 3 million businesses of every size, sector, and region.

The Commission and the Department should be congratulated for holding these hearings and reaching out to the business community for its views on this critical topic.

At the Chamber, we work continuously to promote free market principles, because we see the free market system as essential to ensuring a vibrant and productive economy. And we believe that balanced and effective antitrust enforcement is critical to ensuring a free market.

In the U.S. we support the application of Section 2 of the Sherman Act to conduct that threatens competition and harms consumers. And outside the U.S., we support the application of similar laws.

However, the Chamber believes that the U.S. and foreign competition authorities must use special care in policing single-firm conduct to avoid chilling behavior that is in fact both procompetitive

and beneficial to consumers.

To accomplish this, we believe antitrust rules must be 1) transparent, 2) predictable, 3) consistent across jurisdictions, and 4), reasonably stable over time.

It is important to remember that new products and new business practices are developed well ahead of their actual introduction and ahead of any scrutiny by antitrust regulators. Firms do want to obey the rules of the road, but discerning and applying those rules is becoming increasingly difficult. In its September 5th written

initiative, the Global Regulatory Cooperation Project. This project aims to increase awareness about and to develop successful strategies for combating the growing threat that divergent regulatory systems pose to competitive markets and to international trade.

The need for Global Regulatory Cooperation is clear. Barriers to international trade go beyond market access issues. Traditionally, trade agreements and negotiations have focused largely on tariff reductions. While market access must remain a priority, divergent regulations are increasingly impeding trade, and governments around the world need to better understand the impact in-country barriers have.

While the Chamber's project focuses on many types of divergent regulations, one area that deserves special consideration is competition policy. I'd like to make the following three points.

First, the growing proliferation of antitrust enforcement around the world, together with the globalization of

business creates increasing risk of conflict in the application of antitrust rules to single-firm conduct. These conflicts impose costs on firms and harm consumers and are becoming potential barriers to international trade.

Second, while many differences may be discerned between U.S. and foreign standards for single-firm conduct, the differences in the enforcement approach on tying and essential facilities analysis is becoming increasingly apparent.

Third, now is the time to act on these differences. The U.S. must lead a cooperative effort among industrialized nations to develop and recommend appropriate standards for single-firm conduct and to promote their adoption around the world.

Over the past 15 years, the number of jurisdictions with antitrust laws has grown from about 25 to approximately 100 today. Many of the newer enforcement agencies have limited training, experience, and resources to police anticompetitive behavior and enforce their laws

appropriately.

One thing is certain, the impact of competition decisions by any given enforcement agency no longer is confined by its home jurisdiction. Increasingly, those decisions reverberate around the world, forcing firms to conform their behavior to the most restrictive enforcement policies and increasingly have a negative impact on the global marketplace.

The underlying goals of antitrust enforcement and trade liberalization are similar in that both aim to achieve open and competitive markets. In their application, however, competition laws may sometimes constitute barriers to trade. In some countries, particular enforcement actions may be motivated by protectionist goals. In other instances, differences in general legal standards or in remedies may have a chilling effect on trade.

In her statement opening these hearings, Chairman Majoras remarked that quote: "Disagreement among competition authorities about how to treat unilateral

conduct produces uncertainty in national and world markets, reducing market efficiency and imposing costs on consumers."

Other government officials, both in the Executive Branch and in Congress, as well as many business and Bar Association groups have also joined in recognizing the growing potential for conflict and the costs and burdens associated with it.

The record clearly demonstrates that these costs are very real. For example, Microsoft has been subject to three different sets of remedies in three different jurisdictions for what is essentially similar conduct.

In March 2004, the European Commission held that Microsoft had abused a dominant position in violation of Article 82 of the EC Treaty by tying the purchase of Windows Media Player to the purchase of the Windows operating system and by refusing to share proprietary communication protocols with competitors and allow their use in developing operating systems that would compete with Microsoft's own products.

When the EC issued its decision, then-Assistant Attorney General Pate issued a statement criticizing it as both costly and unnecessary in light of the final judgment entered against Microsoft by the U.S. in 2001.

Later Pate expressed quote "deep concern about the apparent basis for this decision and the serious potential divergence it represents." Noting that "It is unfortunate that considerations of international comity and deference did not, in the Commission's judgment, carry sufficient weight to avoid the significant divergence that has now occurred."

Soon after the EC's decision, the Korea Fair Trade Commission held that Microsoft had abused a dominant position in South Korea by integrating media and instant messaging software into Windows and posing a code removal remedy similar to the one imposed in Europe. On that day the decision was announced, Deputy Attorney General McDonald released a statement stating that quote: "The Antitrust Division believes that

Korea's remedy goes beyond what is necessary or appropriate to protect consumers."

More recently, allegations of illegal tying have been the focus of attack on Apple in Europe. Apple uses Fairplay Digital Rights Management technology to encode songs from its iTunes music online store. As a result, the songs may only be downloaded using Apple iPod devices. Norway's Consumer Ombudsman has found that Apple's DRM policies have effectively tied the purchase of iPods to the purchase of its online music, and has ordered Apple to either license its Fairplay technology to competing producers of music players or to develop a new open standard with those companies.

According to press reports, authorities in Sweden and Denmark may follow suit in formally charging Apple with violation of local laws. And the French Parliament has enacted legislation that may require music downloads to operate across a range of devices, empowering a government body to force digital providers to share the information as needed to ensure such

interoperability.

Significantly, while the EC has launched an investigation into Apple's music pricing policies, the EC investigation reportedly does not focus on this purported tie.

Apple's success has come about as a result of innovation. Consumers voted with their wallets to reward Apple for its ability to innovate and to commercialize its ideas. Competition authorities should recognize the right of innovators to reap the rewards of their innovation. That is to protect competition, not competitors.

Assistant Attorney General Tom Barnett made this point recently in criticizing the attack on Apple pointing out also that quote: "If the government is too willing to step in as a regulator, rivals will devote their resources to legal challenges rather than business innovation".

In addition to these cases involving Microsoft and Apple where U.S. companies have actually been charged with violations of foreign laws based on legal

of abuse of dominance that remain unclear, creating fears of an expansive and inconsistent enforcement approach. Ambiguities abound when firms may be considered dominant and when they may be found to have engaged in illegal tying and other abusive conduct are concerns for the chamber. My written statement contains additional details on China's proposed law.

A greater effort must be made amongst the jurisdictions with established antitrust enforcement regimes to improve the content and the consistency of their rules governing single-firm conduct and then share their learning and comparatively greater experience with countries that may be developing new antitrust statutes or modernizing existing ones. Legislative

conduct and what it means for U.S. companies and consumers. But recognizing the problem isn't enough. The U.S. government needs to address this problem with an increased sense of urgency. The Department of Justice and the Federal Trade Commission have devoted resources for many years to fostering cooperation, convergence, and consistency in antitrust enforcement efforts, as well as in remedies.

They have been successful to a degree, but the success has been realized largely in the cartel and merger enforcement areas. Greater priority must be given to the area of unilateral conduct. Today, a handful of companies have been caught up or face the potential of being caught up in divergent interpretations of anticompetitive unilateral conduct.

However, if this divergence in understanding of single-conduct behavior continues amongst the world's competition jurisdictions, more companies globally will be the target of future investigations and proceedings. It is this divergence that the

Chamber's Global Regulatory Cooperation project seeks to counter.

First, the U.S. government must step up its efforts to encourage convergence in substantive antitrust standards for single-firm conduct, and in remedies. To do that, the U.S. must engage more countries bilaterally, and it must work towards greater convergence in the context of such multilateral organizations as the OECD and International Competition Network.

The Chamber believes there is a significant opportunity for the U.S. government to have an impact in this area, given the fact that the FTC co-chairs the ICN's working group on Unilateral Conduct. In this leadership role, the U.S. should be in a position to call attention to diverging standards and work to reduce and eliminate them, particularly in the tying and essential facilities areas, which have proven so important as of late.

Second, the preliminary draft outline of the Antitrust Modernization Commission recommends that the United States

enforcement and policy development activities with their foreign counterparts, by filing amicus briefs, for example, when U.S. agencies are not conducting parallel investigations.

An agency review should include 1), a review of programs sponsored by other countries as well as the U.S.; 2) a review of the work of international organizations such as the OECN and ICN; and 3), a review of the adequacy of U.S. funding levels and how that funding is deployed.

The U.S. must approach this issue holistically and in cooperation with other developed countries to ensure that available resources are allocated efficiently and effectively and to ensure that other important initiatives such as the protection of intellectual property are pursued.

Finally, the FTC and DOJ must approach these issues with a great awareness of the interface between competition policy and international trade, and the impact the divergent antitrust standards have on trade.

To this end, the FTC, Department of Justice, USTR, State and Commerce Departments must coordinate better on these issues. The Department of Treasury should also be involved, as it looks to lead a strategic economic dialogue with China.

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and his bachelor's degree from the University of Lancaster in the United Kingdom. Bruce.

MR. SEWELL: Good afternoon. Let me begin by thanking the antitrust

With respect to this I will only say the following. Intel prefers to litigate in the courtroom, and I will therefore not use this forum as a -- to argue the merits of our case other than to state that I unequivocally deny the allegations that were made against Intel at the January 30th hearings in Berkeley.

Instead, my remarks today will address the policy issues that have been the focus of these hearings. In particular, I would like to discuss the appropriate role of Section 2 with respect to pricing and discounting practices. I hope that my company's perspective on these policy issues will help to advance the debate that the agencies have generated through these hearings.

At the risk of stating the obvious, the challenge of Section 2 enforcement is to curb anticompetitive single-firm conduct that harms consumers without deterring the type of aggressive competition that benefits consumers through lower prices and greater innovation. This is

a great challenge.

As Professors Baumol and Ordover have observed almost 20 years ago, there is a specter that haunts our antitrust institutions. Its threat is that far from serving as the bulwark of competition, these institutions will become the most powerful instrument in the hands of those who wish to subvert it.

Baumol and Ordover stressed the important concept that rules that make vigorous competition dangerous clearly foster protectionism. And they warned of the runner up who hopes to impose legal obstacles on the vigorous efforts of his all-to-successful rival.

These observations were more recently echoed by Professor Preston McAfee and Nicholas Vakkur who catalogued seven strategic abuses of the antitrust laws, including punishing non-cooperative behavior and preventing a successful firm from competing aggressively.

In his presentation at these hearings, Professor McAfee stressed that the

antitrust laws can be used to harass, harm, and extort in order to induce cooperation.

The strategic abuse of the antitrust laws is of more than a passing concern to Intel. I was therefore particularly pleased to see both Chairman Majoras and Assistant Attorney General Barnett in their remarks at the beginning of these hearings underscore the importance of having rules that do not deter pro-competitive aggressive competition. As Chairman Majoras stated in her remarks: "There is consensus that antitrust standards that govern unilateral conduct must not deter competition, efficiency, or innovation. This is why we frequently worry about false positives. Pervasive and aggressive competition, in which firms consistently try to better each other by providing higher

ignoring the fact that high tech is not limited just to the computer industry. This claim is equally hard to square with reality.

The Agency's most recent actions in the high-tech area include monopolization cases against Microsoft and Rambus, a substantial number of merger enforcement cases involving companies -- software companies such as Oracle, PeopleSoft being the best known, and many other high-tech market cases including communications technology, disaster recovery systems and 3-D prototyping. Also massive fines imposed on DRAM companies and jail sentences on some company executives and ongoing criminal investigations involving SRAM, flat-panel displays, and graphics processors.

The criminal cases and investigations are particularly notable because they involve price fixing, conduct designed to and having the effect of making consumers pay more. It seems eminently sensible that antitrust enforcement should direct itself at conduct that demonstrably

leads to higher prices rather than to attacking price cutting which is the very conduct that the competition laws are designed to promote.

It was suggested at the Berkeley hearing that antitrust enforcement should be directed at price cutting and that the reality, as opposed to the myth, is that consumers are harmed when prices come down due to discounting.

Here I could not disagree more with the position espoused by AMD. On the issue of discounting we have a fundamentally different point of view. We think that enforcement resources are appropriately directed at conduct that makes consumers pay more, not conduct that gives them lower prices.

I believe that our position is supported by both the law as articulated by the Supreme Court, and by very sound policy considerations that underlie the Court's decisions. The Court's statement in Matsushita cogently expresses both the policy and its underpinnings. To quote: "Cutting

prices in order to increase business often is the very essence of competition. Thus mistaken inferences in cases such as this one are especially costly because they chill the very conduct the antitrust laws were designed to protect."

Justice Breyer, while sitting on the First Circuit, made a similar observation in the Barry Wright case. Again quoting: "the consequence of a mistake here is not simply to force a firm to forego legitimate business activity it wishes to pursue; rather, it is to penalize a procompetitive price cut, perhaps the most desirable activity from an antitrust perspective that can take place in a concentrated industry where price typically exceeds costs."

company adheres to its legal obligations without forcing it to engage in gentlemanly competition in which business opportunities are squandered by pricing higher than is needed to win the deal, even though the deal can still be won profitably.

Intel has long enjoyed a cost advantage due to its strong leadership position in manufacturing. And it is important to me and to the other lawyers advising our management that we neither deprive the company of the competitive advantage that comes from its hard-won, lower-cost position nor deprive consumers of the benefit of lower prices, simply because of unclear antitrust rules.

You may have recently read on the front page of the New York Times about Intel's latest breakthrough in semiconductor manufacturing technology. This is the most significant change in the materials used for the manufacture of silicone chips since Intel pioneered the modern integrated circuit transistor more than four decades ago.

It is no accident that Intel

was the first to achieve this breakthrough. Our company has enjoyed unparalleled leadership in manufacturing for most of its existence, and the benefits of this relationship position are very tangible.

With every new generation of manufacturing technology, each of which is introduced on a roughly two-year cycle, we double the number of chips that can be produced on a wafer, holding both the wafer size and the chip design constant. This means that the manufacturing cost of any given chip is cut by roughly 50 percent when the new manufacturing technology is introduced.

Now, it's a little bit more complicated than that because we tend to take advantage of this lower cost to put more features onto the chips which trades off some of that cost savings for better performing products. But the cost advantage of being first to adopt the new manufacturing technology is large and tangible. Our recent manufacturing technology breakthrough will ensure that we can continue to progress along

market share discount, the discount should be lawful if the price, after all discounts are taken into account, exceeds the defendant's marginal cost or average variable cost. That is, such discounts are covered by antitrust or antitrust's ordinary predatory pricing rule."

A similar approach has been proposed by former FTC chairman Tim Muris, who advocates a modified Brooke Group test based on whether the price of the total amount of goods sold exceeds the cost of the goods.

Cost-based rules have a number of advantages beginning with the avoidance of false positives. They enable companies to base pricing decisions on what they know, that is, their own cost structure and the relationship of price to cost instead of speculation about the meaning of

since 1993. His responsibilities include litigation and regulatory matters, including those relating to airport access, airport rates and charges, aviation disasters, patents and trade secret litigation, international competition, airline alliances, and antitrust and consumer class actions.

Bruce serves on the ABA Air and Space Law Forum and has written a number of articles relating to legal issues affecting the airline industry.

He received his JD from Georgetown University Law Center with Honors. Bruce.

MR. WARK: I absolutely view it as a privilege to be here today, so I'd like to join others in their opening comments by thanking the DOJ the FTC for the opportunity to appear here today.

As an in-house attorney at American Airlines who is responsible for competition matters I hope to offer a unique perspective, one that has been defined by the important, turbulent, and highly competitive nature of the airline industry.

The second recent predation decision in the airline industry came in a case that was brought by Spirit Airlines against Northwest Airlines. As in the case against American, in that case the District Court held that Spirit had failed to prove that Northwest had priced its products below average variable costs on the routes in question, and therefore, the District Court entered summary judgment.

On appeal, and unfortunately in my opinion, the Sixth Circuit reversed in a decision that, I believe, fails to apply the objective standards that are absolutely necessary to distinguish between aggressive competition and illegal predation under Section 2.

I want to use these two cases today to support two important themes. The first is that predatory pricing claims unconstrained by objective standards and based on unproven economic theory harm the competition that the antitrust laws were intended to protect.

As Judge Easterbrook has

will continue to have to be decided on their own merits, and general legal principles will have to be applied to unique facts.

That said, improving of clarity of legal standards in this area should be pursued, and there are areas where clarification can be immediately accomplished such as a clear endorsement of average variable cost as being the only appropriate measure of cost in a predation claim.

In our industry, despite the fact we have two fairly recent Circuit Court decisions addressing predatory pricing, Section 2 standards remain unacceptably vague. And even worse, as I've indicated before, I believe the Sixth Circuit decision in Spirit fails to demand the objective standards that are necessary to show that aggressive competition has overstepped the bounds of the law and is a decision that protects smaller competitors rather than competition on the merits.

Before discussing the American decision and the Spirit decision in

more detail, I think it's useful to give some general observations on the airline industry and how we compete.

The airline industry is the backbone for much of U.S. commerce, and the antitrust scrutiny that we find ourselves under is no doubt a product of the important role that the industry occupies.

Last year alone American served about 100 million passengers. We took in about 20 billion in revenue. Yet those figures, as impressive as they are, account for only about 20 percent of the U.S. domestic airline industry.

Until the early 1980's, the airline industry was a regulated business. But since deregulation, the industry has exploded, and air travel today, although far from perfect, is largely affordable and convenient.

Airfares in real terms have fallen significantly, and American and other carriers are now able to offer thousands of convenient on-line connections that did not exist in the regulated environment.

At the same time, new entrants are consistently entering the market with new aircraft, lower costs, and new ideas on how to succeed in this crowded and mature marketplace. One or more of these low-cost carriers operate in over 80 percent of the routes that American flies.

Clearly, competition has served the air traveler well. Shareholders and other stakeholders haven't faired quite as well however.

American is the only Legacy Network carrier that's never filed for bankruptcy. And since the turn of the century, we've lost billions of dollars and have had only one profitable year, that was last year, where we eeked out a profit margin of roughly one percent.

These results here aren't intended to engender your sympathy, but simply to remind us that the competition in this industry is not only very dynamic. It's often brutal.

Each day the people at American have to make decisions on how

a position that is predetermined by the requirements of its claim.

As I'll explain shortly, I believe that's exactly what happened in [illegible]

altered our conduct based not on what we thought was illegal, but on what we feared others might argue is illegal. And in these circumstances competition has likely been compromised.

Our experience with the Department in its predation case illustrates how Section 2's lack of clarity can lead to significant disagreement between industry enforcement and how, at least in our opinion, overly aggressive enforcement actions threatened the competition that the antitrust laws were intended to protect.

In making that comment, however, I want to note that although we disagreed with the Department's theories and decisions in that case, we didn't question their good faith. Despite those differences of opinion, I don't doubt that they decided to pursue the case against American, and they believed in the merits of their arguments and believed that they were fulfilling their obligations to protect competition and consumers.

Indeed, if they're like a lot

of lawyers that I know, I suspect that despite the loss, they still think they were right and it's the courts that got it wrong.

These good-faith but extremely important disagreements simply highlight the problem of the current state of jurisprudence under a Section 2 predation claim.

Let me put our dispute with DOJ in a bit more historical context. The lawsuit was brought in the mid to late 1990's, at which time the airline industry, like the rest of the U.S. economy was operating near the peak of the business cycle. American and other large network carriers were profitable. And although those profit margins were generally in the single digits and was modest compared with other industries, they were very good when compared to the industry's historical returns.

In response to these conditions, a number of new entrants entered the market, some such as Frontier and Air Tran are still flying today and are generally recognized as being successful. Other new

entrants that were less well managed and financed disappeared.

The failure of some of these new entrants led to concerns that the markets were failing and that the actions of incumbent airlines, like American, where we matched pricing and expanded output was actually harming competition.

The Department of Transportation even considered reregulating the industry when an incumbent carrier matched prices or expanded output in response to new entry.

Fortunately, that regulatory initiative failed, and the following five or so years demonstrated that the marketplace was far more resilient and dynamic than the average regulations demanded.

By the year 2000, Jet Blue and others had shown that a well-financed and managed new entrant could succeed. And ironically, a lot of that growth was in the

passengers traveling on any type of connecting itinerary. And second and even more surprisingly, they removed from the calculation passengers who paid more than $225 for their ticket.

That analysis, of course, was completely unrelated to any analysis that Northwest would have undertaken at the time it decided to add in price due to capacity on these routes. Northwest instead would have asked a much more straightforward and appropriate question, that is, with new lower fares and additional capacity, would it be able to generate sufficient revenue from any

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revenues on the routes exceeded its average variable costs. This caused the department to develop alternative tests. American had argued against cost measures that included as much as 97 percent of total costs. And others had argued in effect that American's decision failed to maximize its profits.

My point for purposes of this hearing is simply this. There was a great deal of disagreement as to what items of cost were properly included, how these costs should be calculated, and how revenues should be attributed to incremental costs.

Although we prevailed on this basis, the Tenth Circuit decision left many of these disputed questions unanswered.

The Tenth Circuit also left unanswered the important question of whether there should be a meeting competition defense in a Section 2 context.

The problem of residual uncertainty in the Tenth Circuit case concerning these questions however is not nearly as problematic in my mind as the Sixth Circuit's treatment of this question. And

what I believe is certainly the most troubling statement in its decision, the Sixth Circuit stated, and I quote here: "Even if a jury were to find that Northwest's prices exceeded an appropriate measure of average variable costs, the jury must also consider the market structure in this controversy to determine if Northwest's deep price discounts in response to Spirit's entry and the accompanying expansion of its capacity on these routes injured competition by causing Spirit's departure."

This statement from the Sixth Circuit offBTfuno objectie itatndard forthe

by offering some specific suggestions concerning Section 2 enforcement. First, given the ambiguity in the law and harm that a false positive can have in this area of the law, regulators should proceed very cautiously. I believe that especially in the context of a single product pricing case, regulators and courts should heed the Supreme Court's guidance that well-founded claims are extraordinarily rare, and that overly aggressive enforcement can harm competition.

Predatory pricing claims are not an area of the law where regulators should pursue aggressive new theories or rely on untested economics.

Second, markets are more resilient than is often appreciated at the time. The experience in our industry has debunked many of the theories and assumptions concerning the market, like that of the fortress hub that motivated the Department of Transportation to consider re-regulating the industry and encouraged the Department of Justice to file its lawsuit against American. Trusting markets to perceive shortcomings is

There were times in our dispute with the Department that we would have liked to resolve our differences, but the remedy imposed by the Department would have been competitively debilitating for American in a highly competitive industry.

Finally, predatory pricing is an area of the law where remedies are more prone to doing more harm than good. I hope that these comments have been useful, and I look forward to the moderated portion of the discussion.

(Applause)

MS. GRIMM: I'd like to thank our presenters for their very fine presentations. We will be resuming in about 15 minutes. We'll take a break until then.

(Break Taken)

MS. GRIMM: I would like to start at the end with Bruce Wark. Bruce, do you have any comments? Do you have any questions of your fellow panelists?

MR. WARK: Well, there was a great deal of commonality, I think, between what I said and what Bruce Sewell said. So

I'll just tell you -- say he was right and leave it at that.

On the question of convergence, I agree it's an absolutely important policy goal and needs to be pursued. But equally importantly, you need to make sure you converge at the right place. And you know, particularly with the E.U., they have a different tradition. They have different biases. I think they are more inclined to protect competitors at the expense of competition. And what I wouldn't want to see is convergence away from what we think is the right standard, which has been developed in this country. And I think the standards employed in this country are the

measure, and I think we're going to explore

would like to delve into this question of average variable costs in some more detail. Both of our Bruce panelists have definitely endorsed that as a test, I would say. And I would just like to ask each of them to basically tell us more about how average variable costs are kind of arrived at in their particular industry.

This morning we heard one of our panelists say that he did not think average variable cost was the right test, especially in high fixed cost industries. And I would just like to hear some more discussion from you on how the average variable cost test would be applied.

MR. WARK: Yeah. Want to begin with me again?

MS. GRIMM: That would be fine.

MR. WARK: I think it's important to recognize that average variable cost is really a proxy for marginal cost because that really it the right test.

And when you talk about average variable cost, one of the questions

that gets buried in the next level of analysis is variable over what period of time because, you know, everything is variable if you give it enough time.

That said, I do think that average variable cost on an appropriate time frame is the best test because it provides clear guidance. And I think the problem you

start with one of the principles that I tried to make in my written statements. The laws that we're seeking to conform need to be understandable by the people who are asked to adhere to them. And that leads you to look for ways that you can translate concepts that are relevant for antitrust enforcement into concepts that are also common for business people.

And average variable cost is a measure which is widely understood by business people, and I would argue particularly in my industry, potentially in Bruce's too, it's a metric that exists for other than just antitrust enforcement purposes, which means that it's also a metric which exists for legitimate business reasons, and therefore has some additional validity, I think, when you're asking for companies to talk about average variable costs.

We at Intel have a model which enables us, and in fact we do a lot of our business planning based on average variable cost or marginal cost.

Once the fabrication plant

has been built, we have to track the cost of the wafer through that plant. And we've become quite expert at understanding and identifying the various components that have to go into creating a final finished microprocessor, so the cost of the wafer, the cost of the electricity to power the wafer through the plant, the cost of the etching and the chemicals. All of these constituent pieces that go into actually moving the wafer through the plant itself.

And this is a model. It's a metric that we use regularly in business. So for that reason, both intellectually, I think, is the correct way to look at the price in question from an antitrust perspective, but it also has that added benefit of being something that business people use in the ordinary course of business, and therefore it has that extra validity.

MS. GRIMM: I'm going to follow up with what might be a naive question, but what is the average variable cost of a microprocessor that you produce?

looking at. If we could get more information on that, that also would be helpful.

countries have, whether it be through bilateral, multilateral, or organizations like the WTO, there's an adequate mechanism by which to address these problems.

And so these kinds of in-country barriers are important going forward if we're going to protect a global economy and I think continue to go after open and competitive markets in a way which builds on what we've done in the past.

So the U.S. Chamber aims to begin to focus the U.S. government and governments around the world to meet this challenge over the next 50 years in the same way in which the world took on the challenge to opening up markets in a tariff-related sense.

In terms of how we're organized, we have got a number of member companies that have been members of the Chamber who have expressed specific interest in this project, see the need for it, see that this being the future of trade discussions and negotiations. And so they've challenged us to take this project on and

moved forward. And we have them serving in a steering capacity.

We are advancing on a number of different fronts in each of these different buckets, including today on the competition policy front.

I think most notably in the news these days is Chancellor Merkel, the E.U. president, German Chancellor, has advanced the notion of a cooperative dialogue between the U.S. and the E.U. on regulatory issues. And so we're going to start there.

Then additionally we'll begin to work through international department on China. We see that in a working partnership with the Treasury Department and the Strategic Economic Dialogue that's in place advancing these same kinds of principles and goals to bring about some sort of regulatory playing field that's more common than the patchwork that we see currently existing.

MS. GRIMM: You mentioned tying and essential facilities as two areas

that you're particularly concerned about, and those are also the areas that you highlighted in your comments that you submitted in September.

Are there any areas aside from tying and essential facilities that you are concerned about internationally?

MR. HEATHER: Internationally, let me answer that by saying this. We are interested in making sure that again this is not convergence for convergence sake, but that there is a uniform standard that's being applied by antitrust jurisdictions around the world, and that standard is one that is resonating from what we see here in the United States happening.

So while the comments that we made back in September talked about tying and essentially facilities, our concerns internationally go beyond that to any particular Section 2 type action, whether it be Article 82 of the E.U. or similar laws in countries around the world.

And I think the reason which we brought up the tying and essential

principles that could be used in areas where there's not convergence. You mentioned Assistant Attorney General Pate's reference to comity principals. And then later in your discussion you mentioned agreements to defer among international competition agencies.

I'd be interested in your thoughts on that area in general. And Bruce, I suspect this is something you've thought about as well, and Bruce you as well have at it.

MR. HEATHER: In my comments, I think you're referring to where we talked about enhanced comity. And while the U.S. Chamber's not at this point prepared to say enhanced comity is the exact way to go, we believe that exploring that further is a potential option.

I think that one of the things you could do in terms of creating standards across the board is potentially the use of safe harbors, in the sense of safe harbors in what I believe would be termed the positive saying that if you have a dominant market share position of 50 or 60 percent, that

that is not defined as a dominant position, or to suggest certain conduct regarding tying or rebate policies and the like does not constitute an abuse of the dominant position. Coming up with some standards that could be adopted internationally would be one way by which you could put that kind of language into agreements between countries and then exploring the area of enhanced comity where potentially you could defer to decisions of other jurisdictions.

MR. SEWELL: Yeah. On comity first and then on safe harbors. The reality is that sovereign countries and sovereign trading blocs, that's the right way to describe the E.U., are going to regulate, are going to exercise their sovereignty. That's perfectly within their right to do so.

The problem, I think, is when you have agencies which are really reaching outside of their own geographic or area of sovereignty in trying to regulate conduct which occurs outside of that area.

So for example, where you

have an agreement between two U.S. companies to price at a certain level, and then that gets reviewed in a third country which is not the host of either of those two companies. And the analysis then becomes can two U.S. companies price in a way which the U.S. would find acceptable but yet some other agency does not? And in those circumstances I think the principles of comity should really be argued and be respected by the agency that's outside of the -- in this case outside of the U.S.

Where there is a clear nexus back to non-U.S. competition, so in the case of Europeans, where there is a European actor involved, that's a more difficult argument to make.

But certainly where there is no European actor involved and where there's a tenuous connection at best back to European commerce, then I think it's important that issues of comity are respected.

With respect to the safe harbor question, I actually think -- I agree with you entirely that we are not going to

get international convergence or harmonized antitrust laws any time soon. But I think there is a role for the safe harbor here. I think there is a threshold standard which some number of these 100 antitrust regulatory agencies around the world might be willing to agree should represent the -- sort of the bare requirements with respect to antitrust conduct. And that so long as companies are complying within that threshold standard, that companies should at least have a safe harbor from punitive litigation.

And it might be that that's the first step in driving towards what would ultimately become a more harmonized set of international standards.

MR. WARK: I really don't have a whole lot more to add on that issue. I think the points have been well made.

MS. GRIMM: I'd like to ask our panelists a question similar to that that was asked of our morning panel, and that is in the area of loyalty discounts, whether market share provides a useful screening mechanism in assessing the legality of such

discounts, why or why not. And Bruce Sewell, maybe you can take a shot at that first.

MR. SEWELL: Let me start with what I think you're asking and then feel free to probe a little bit.

I don't fundamentally see the loyalty space as different or as requiring different treatment than a standard pricing inquiry would demand. So I don't see perhaps the relevance of the market share test.

It seems to me that whether the discount is in the form of a loyalty discount or some other form, the essential inquiry remains the same. Is the price that's being offered across the units being sold above or below a predatory level? And if the answer is that the price is above what we've defined as a predatory level, then I think that ends the inquiry.

If the price it below a predatory level, then I think there are remedies available and laws available to deal with that. But I don't see it as a different analysis.

MS. GRIMM: Bruce Wark, do

you have anything to add to that?

MR. WARK: Yeah. I think I bring almost a unique perspective because I think we have one of the world's most famous loyalty programs. It's called Advantage. And I think that anybody who looks at that and looks at how the loyalty program at least in our industry has grown up, it's absolutely pro-competitive. It's a point of competition that airlines engage in.

On the other hand it's not exclusionary. It's clear that new entrants have been able to enter markets, either by developing their own loyalty programs, hooking those loyalty programs onto the loyalty programs of other airlines who may want to do the same thing, making their loyalty programs maybe quicker and easier to redeem.

Or take the example of an airline like Jet Blue, which may say well, maybe what I'll do is I'll compete on some other ways and product.

So I think the Advantage program in the airline industry is a great

MR. WARK: One other point I guess I want to make which goes back to the original question is what role does market share play. And again, I think the airline industry is interesting because we're 20 percent of the U.S. market, which no one's going to say is dangerously close to establishing monopoly. But maybe on an individual route or out of an individual hub we'll be 70, 80 percent of it.

So are you going to apply the 70 percent or the 20 percent? So that really gets into what's your relevant market on the loyalty program, and could you really run a different loyalty program based upon the location of the particular participants in that program.

So I think when you ask the question what market share means, at least in my mind, part of the question is being able to find relevant market for purposes of the loyalty program.

MS. GRIMM: Bruce Sewell, as I understand it, Intel has faced or is facing inquiries in a number of different foreign

has in the market?

And I think in that area the U.S. leads with its willingness to study effects as opposed to exclusively conduct for a formulistic approach.

So the result that may obtain in Europe should the European competition authorities decide to bring an action against itself might be different because of the application of a different test. We're not there yet, but I worry that that's the case.

Sean mentioned the Chinese anti-monopoly law. It's not at all clear what kind of standards the Chinese would use in assessing market share or in assessing conduct under the anti-monopoly law.

It's not currently an issue for us. We're not currently under investigation in China. But it is not at all inconceivable given that we are subject to a competitor which has chosen to use a serial antitrust complaint approach, that we may find ourselves having to defend our conduct in China at some point. And I have very little confidence that I today could

tell you what standards would be used by the Chinese government, how that would be understood.

MS. GRIMM: Thank you. I'd like to ask you a general question here again, both Bruces, I'd appreciate your responding.

We've talked about loyalty discounts. We've talked about predatory pricing. I am wondering if there are any other areas under Section 2 that you think need more guidance from the agencies, areas perhaps in which we could consider safe harbors, areas maybe needing the announcement of some presumptions. I know it's a broad question, but I wonder if you've given any thought to this, or in your experience that there are any other issues that you've found to be of particular concern.

MR. WARK: Let me think on that a little bit. I mean, I spoke on predatory pricing in large part because as the provider of essentially a single product, I don't run into some of the bundling issues. There aren't a whole lot of exclusive dealing

concerns in my business.

And obviously having defended a predatory pricing case and having seen what happened in the Spirit case, that is the issue which is of most importance to me.

So I guess, as I listen to Bruce, I'll think whether there's any other areas. I'd be happy to have that one taken care of.

MS. GRIMM: Fair enough. Bruce?

MR. SEWELL: There isn't a1

I think also we could use some clarity in that space.

MR. MATELIS: This might be a different way of getting at sort of the same point, but Bruce Wark, you mentioned in your remarks that you can recall some instances where American refrained from what you thought was pro-competitive conduct out of fear of baseless antitrust suits.

Without going, you know, into the details too much, could you explain in general what sorts of things you were thinking about and, Bruce Sewell, maybe you have some perspective on this as well. And Sean, anything that your members have relayed to you would be of interest too.

MR. WARK: In the Section 2 context it became clear from our litigation experience that the Department was as much concerned with capacity decisions as it is with pricing. Now, from our perspective they always went hand in hand because when you get a lower price, you now want to compete for anybody who might be into that lower price, which is going to be a bigger universe than

what you started with.

But it was at least in the DOJ's theory and it was also the theory in the Spirit case that maybe you could match the competitor, but you shouldn't expand capacity.

Also when you go back and you look at the history of what the DOT was proposing, they were basically idea of being well, you can match price, but we just don't want you expanding output.

So with that sensitivity, you know, we really do have to sit there and say okay. We have to look at the market and say well, are we comfortable expanding capacity in that market, knowing that although we think it's perfectly legal and pro-competitive, are we going to have to re-address this thing that we're adding capacity where we shouldn't.

There are a couple of other examples that primarily also we've had some other disputes with the Department about, more along the line of Section 1 cases and how we publish fares. And details probably

wouldn't interest too many people here. But that's also another area where we think we would have to be conservative, in large part not because we think we're wrong, but because, you know, we're not interested in having another argument.

MR. SEWELL: I don't want to give you a flip answer. The temptation would be to say whatever happened, we haven't been very successful at it because we are currently being sued.

The structure of my industry is a little different than Bruce's. We really primarily are worried about one particular competitor. And I can't think of any situation in which we have foregone an opportunity that was demonstrable and was

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routinely challenged.

So I don't think we intentionally leave money on the table, as it were, or intentionally price in a way which does not seek to provide the maximum benefit to consumers. But we spend an awful lot of time trying to make these decisions.

And as is apparent, we don't always get it right in the sense that we're not successfully avoiding the litigation. We absolutely believe that we can defend the decisions that we've made, and we'll eventually have that opportunity.

But it is a cost. It's a large cost for doing business. And it would be helped in large part by some clearer rules so that we could set systems and educate our clients with greater certainty about where the lines need to be drawn.

And then we would still probably have to defend ourselves in court, but it would be on the basis of greater certainty.

MR. HEATHER: If I heard your question right, it's do legal

environments lead to businesses making decisions based on those.

MR. MATELIS: Right. And then in particular, are there pro-competitive pro-consumer business decisions that companies -- you know, your members, for instance, are avoiding because they fear antitrust liability in some form?

MR. HEATHER: Well, our members have told us on numerous occasions that obviously in the general sense that these kinds of legal environments do impact their business decisions. And we most readily track that through our Institute of Legal Reform, which has been around for the last four or five years. We release a study study annually that ranks the 50 states on whether or not they have a positive legal environment that encourages business investment or whether they have a legal environment that discourages business investment.

In that survey we haven't gone into antitrust issues, so I would leave it at generically stating that yes,

there is a link between cause and effect. And obviously companies react and make their business planning based on the legal environment.

MS. GRIMM: I'd like to pursue that a little bit more in the international context again and basically ask very much the same question that was asked of our panelists this morning.

In terms of how businesses such as yours, Bruce and Bruce, respond to variations in the competition laws internationally, in particular I'd like to know, for example, whether your business decentralizes decision making as to different foreign environments. Secondly, whether your business generally seeks to comply with the most restrictive laws in those environments. I'd also like to ask whether the uncertainty could even impact on where you, for example, Intel, put your factories.

And fourth, I think maybe you answered this, but whether the difference in international enforcement standards substantially raises your cost of doing

business. Those are kind of four subquestions under the large question. But if you could try to address those, it would be helpful.

MR. SEWELL: Sure. I'll start, and then if I miss one, then let me know.

We start with the position that as a global company, we need to be compliant with the antitrust laws globally. And since there is not a unified standard for that, we have to look at each area in which we do business.

For Intel philosophically, we start with the premise that we must be compliant in the U.S., and then overlay that U.S. compliance approach with foreign requirements to the extent that we can discern what those foreign requirements are.

So at any given point, we would be able to answer this question by saying we are sure we are compliant with U.S. antitrust law, and we are doing everything that we can to be compliant with foreign antitrust law although it's more difficult

as to where to locate a factory tends to be

isn't a whole lot of foreign investment is U.S. airlines in part because of law and vice versa.

So my competitive footprint in Europe, being the most important example, is small. So I never really have to worry about an Article 82 claim standing alone.

I think where those issues do come up for us is we compete with airlines like British Airways, but we also cooperate with airlines like British Airways through airline alliances.

So for example, I may be competing with them between Chicago and London, but I may be cooperating with them to move somebody from Chicago to Tel Aviv.

So we're kind of in this interesting position of sometimes competing with airlines, sometimes cooperating with airlines. That's more of a Section 1 or an Article 81 issue, although you do have this kind of concept of collective dominance. I don't know that anybody really knows what that means under Article 82. I think that's being developed as we speak.

So when we talk to the other airlines about what we can do as an alliance, I can say that we always have to fall to the lowest common denominator. I personally believe there are some very pro-competitive things alliances can and would do but for the fact that again, you're always operating on the lowest level for fear that you will stumble on what is the highest competitive hurdle.

MS. GRIMM: I have no more questions.

MR. MATELIS: Something that a lot of people have spoken about today are loyalty discounts. Bruce, let's start with you. I wonder if you could -- you know, I think most people intuitively grasp how loyalty discounts help firms get business. But I wonder if you could help tell us by tracing that through to the potentially pro-competitive effects on consumers.

MR. WARK: Which Bruce?

MR. MATELIS: Bruce Sewell.

MR. SEWELL: Maybe I'm missing something, but the trace-through from

MR. SEWELL: Well, in our industry it can be very significant because issues of scale have such a direct impact on the cost. So from our perspective, there are pro-competitive and pro-business reasons for looking to expand the scale and the volume of parts that we sell.

So I'm not sure that's directly a consumer benefit, but it's certainly a business justification for the discounting practice.

MR. MATELIS: Bruce Wark or Sean, any thoughts?

MR. WARK: I wouldn't add anything to that.

MR. MATELIS: Okay. I wanted to return to something that Bruce Sewell mentioned earlier and ask it of you Bruce Wark. Bruce said that at Intel, average variable cost is a readily available figure often. Is that the case at American as well?

MR. WARK: Well, we had a very long piece of litigation where in fact there was a great deal of argument about what

average variable costs should be. I think we thought we knew what it meant for purposes of that case. It was a different number than what the Justice thought the number should be.

MR. MATELIS: I don't mean to interrupt you. But outside the context of litigation, is average variable cost a concept that -- or a figure that is important to American's own internal deliberative process, or do you have different ways of thinking about your business?

MR. WARK: We have a route accounting system that takes account of all kinds of different layers of cost, from fully allocated to something that is much more variable. So yes, I think that the short answer to your question is yes.

MR. MATELIS: Another predatory pricing question for -- I guess for you, Bruce Wark. You mentioned in your prepared remarks that you thought it was appropriate to acknowledge a meeting competition defense in the Section 2 context. I guess the flip side to -- or the argument

against the meeting competition defense is that if it precludes liability in exactly those situations where, you know, a low-cost -- a lower cost new entrant might be seeking to enter, and a higher cost incumbent lowers cost. So in that instance the meeting competition defense would provide a safe harbor for sort of the core theory of how predatory pricing can work to harm competition.

Sort of in general give me your thoughts on why the meeting competition defense is appropriate and why my attempt to defend it might not be the right way to look at it.

MR. WARK: Well, I think from the perspective of the alleged preditee, they picked a point in the marketplace where they have to decide they're going to be successful. We didn't.

It is a different situation than when that cost is imposed on them. If I went out and imposed a cost on them that was below my measure of marginal or incremental costs with the intention of

driving them out, and they couldn't survive at that price, then that would be a different situation than when you have the alleged victim setting the price in the marketplace.

If they raise their price and we didn't follow, that might be a different fact. But I think that if a competitor that basically sets its own price in the market can't survive, it's not the kind of efficient competitor that the competition laws are intended to protect.

MR. MATELIS: Do you have any thoughts on how easy or hard it is to compare costs when you're seeking to apply the meeting competition defense? Is the cost comparative always intuitive, or are there hidden costs that make that comparison difficult?

MR. WARK: Well, I guess what I'm arguing is that the defense, you don't have to worry about my costs. I ought to be able to compete for every passenger I can at the price determined by my competitor.

MS. GRIMM: I think those are all the questions that Joe and I have.

I would like to ask our panelists if they have any additional questions or observations they'd like to make.

MR. WARK: Just to simply extend my thanks again for the opportunity.

MS. GRIMM: And I'd like to thank all of you for joining us here today.

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