Federal Trade Commission

"Competition Choke Points?"

J. THOMAS ROSCH[1]
COMMISSIONER, FEDERAL TRADE COMMISSION

before the
GLOBAL FORUM
Paris France
November 9, 2006

Introduction

Competition regulators on both sides of the Atlantic have long heard complaints that a single firm's control of an "essential" facility gives that firm an unfair advantage in other markets. For example, in the United States, concerns have been raised about the ownership of telephone "local loops" that are chokepoints for the transmittal of voice and data, and the cable tv lines that transmit television programming and increasingly data. More recently, some "net neutrality" proponents have raised concerns that "broadband duopolies" of phone and cable companies could discriminate in the quality of broadband Internet service provision and thereby undermine innovation and business opportunities available to Internet content providers. Others have argued that it would not be in the business interest of the phone and cable firms to do so and that, in any event, the antitrust laws can readily address any competitive problems that may arise in this area. These examples share several common features. For one thing, they are conduits or "pipes" that deliver goods – content – from suppliers to consumers. For another thing – more

[1] The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am greatly indebted to my attorney advisor, Kyle Andeer, for his significant contributions to this paper.

there are no ready substitutes now or in the near future for most consumers or OEMs that use them.

In analyzing whether facilities are "essential" in this sense, one should be aware of competition between "platforms." For example, in the United States we are beginning to see competition between cable and telecommunications firms. My wired telephone provider now offers tv service (in collaborations with Direct TV) as well as DSL service. At the same time, traditional cable television providers are offering internet and telephony services. Wireless providers, and even the local electric company, are exploring ways to offer these services. One could imagine a future in which the consumer shopping for television could choose between as many as four or five different alternatives. Consumers or OEMs could substitute one for another if they are dissatisfied with the product or service they are getting.

A facility that does not face actual or potential competition, however, may confer unique power over output, price and quality upon its owner – power that may extend to related and adjacent markets. It is strongly arguable that antitrust law enforcement authorities (or Competition authorities, as the rest of the world outside the U.S. refers to us) should carefully scrutinize both the origin of the owners' unique power and the way that power is exercised. More specifically, to the extent the owner of such a facility engages in inefficient competitive conduct that harms consumer welfare, a substantial antitrust issue may present itself.

The Origins of Power

I do not want to suggest that "essential facilities" are inherently pernicious. Far from it. Sometimes such a facility results from innovation, which would not have occurred without the promise – or at least the prospect – that the innovator would enjoy the power for a period of time. Under those circumstances, the power is consistent with consumer welfare. Indeed, anytime that the power results from superior skill, industry or foresight, to prevent its exercise would chill conduct that benefits consumer welfare.

Sometimes the dynamics of a particular market are such that it will tip to a market "standard." The standard may be determined by competition – for example, the battle between Beta and VHS in the eighties. Standards may also be set through a formal standard setting process. The joint development of standards by competitors – essentially replacing competition – raises additional issues. However, where the standard adopted results from a fair and open contest between or among alternatives, competition exists ex ante and the process tends to maximize consumer welfare. Standards may enhance consumer welfare where a welter of different technologies cannot efficiently coexist.

Governments may also play a role in the formation of an essential facility. In some cases the government may have established a monopoly in a particular market only to later transfer ownership to the private sector. Under those circumstances, it cannot be said that the transfer has created power over output, price and quality since that power existed previously. Indeed, if and to the extent that private enterprises are subject to antitrust or competition laws and state enterprises are not, the transfer has the potential to enhance consumer welfare.

Yet the power can be acquired illegitimately. In the United States, patents may confer enduring monopoly power in certain markets. If those patents result from fraud or other wrongdoing then that raises concern. If the power stems, in whole or in part, from a standard, it may result from deception or unfairness in the standard-setting process. If the power stems from an acquisition, it may result from a material reduction in the competition that would otherwise exist in the marketplace.

Determining whether power has been acquired illegally is not always easy. Take, for example, the way that Xerox acquired power over the plain copier market in the mid-60s. It acquired the so-called Battelle patents in a series of acquisitions that began long before there was such a thing as a plain copier market. The FTC challenged those acquisitions as having tended to create a monopoly, and the challenge resulted in a consent decree (later modified) that imposed licensing oblig having tended to

[5] *Xerox Corp.*, 86 F.T.C. 363 (1975)

[6] *SCM v. Xerox Corp.*, 645 F.2d 1195 (2d. Cir. 1981)

excluding rivals. But courts in the U.S. at least have been loathe to second-guess engineers who say that these features constitute improvements in the product.[7]

Indeed, evaluation of the effects of orthodox mergers and acquisitions is frequently difficult. For one thing, as the *Oracle* case demonstrated, it may be hard to define relevant product or geographic markets in which the transaction is occurring, and hence to determine whether it is likely to result in the power to exploit consumers.[8] For another thing, even if the transaction or conduct at issue may produce power in the short term, the potential for new entry may make the power fleeting. The courts and commentators have not even settled for sure how long power must endure in order to justify a challenge. In the U.S. our Merger Guidelines take the position that entry must occur within two years or else too much consumer harm will occur before the power is dissipated.[9] But even in the U.S. there is a debate about whether that time period is too long or too short as a matter of policy. Moreover, unless entry has actually occurred, evaluating entry claims often requires a crystal ball. Who would have predicted two decades ago, for example, that cable tv operators would be competing with telephone and maybe power companies who have wires running to homes? For that matter, who would have predicted two decades ago that the telephone companies providing local service would be competing with wireless service providers and internet service providers?

So second, whether the conduct is to be condemned or not depends on the context in which it occurs. For example, in the U.S. it is doubtful that the owner of an essential facility must make that facility available to a firm that wants to compete with the facility. However, it

---

[7] *See e.g., Cal Computer Products, Inc. v. Intern. Business Machines*, 613 F.2d 727, 744 (9th Cir. 1979); *ITC Peripheral Leasing Corp. v. IBM*, 458 F.Supp. 423, 443-44 (N.D. Cal. 1978).

[8] *United States v. Oracle*, 331 F. Supp.3d 1098 (N.D. Cal. 2004).

[9] U.S. Dep’t of Justice & Federal Trade Comm’n, Horizontal Merger Guidelines § 3.0 et. seq. (1992) *reprinted in* 4 Trade Reg Rep. (CCH) ¶ 13,104.

sometimes happens that the facility is part of a vertically integrated enterprise--for example, its owners also produce "upstream" products or services in competition with rivals who must sell those products or services to the essential facility in order to operate at the minimum viable scale to compete effectively. In those circumstances, there may be a duty to deal with the upstream rivals and to do so fairly – or at least there may be a duty to justify the refusal to deal on some basis other than suppression of the upstream competition.

Countermeasures must also be considered. If and to the extent that rivals can combat exclusive dealing contracts, tying or bundling by their own price terms or by marrying others who will enable them to offer the same bundles on competitive terms, it cannot be said that the conduct is really harmful to consumer welfare. To the contrary, the conduct in that context may actually stimulate competition that might not otherwise occur and thereby contribute to consumer welfare.

A third factor that must be considered is the consequence of law enforcement action. In a nutshell, it should not deter innovation or efficiency. A great debate is raging right now about what standard should be used in evaluating the conduct of essential facilities (if any standard is appropriate for all conduct.) It has been suggested, for example, that conduct should be challenged if, but only if, it would not be undertaken by a rational firm except for its exclusionary effect on rivals. It has also been suggested that a more appropriate test is whether the conduct would exclude an equally efficient rival. However, most if not all observers agree on one thing. That is that a challenge is not appropriate if the conduct benefits consumers by delivering products and services to them more efficiently.

Conclusion

In some instances, however, it simply cannot be said that the creation or implementation of this power is consistent with consumer welfare. Antitrust and competition authorities around the world have the tools – and responsibility – to prevent the wrongful creation or use of power or to dissipate it if it has already been created or is being misused. In the U.S., our tools are the Sherman and Clayton Acts. In the EC, they are Articles 81 and 82 of the Treaty of Rome.

The Global Forum is occurring at an especially propitious time for those of us who are involved in antitrust and competition law enforcement. We in the U.S. are holding a series of hearings on enforcement of our laws governing conduct by those who enjoy monopoly or near-monopoly power. Our colleagues here in Europe are focusing on the same subject, only under Article 82, and I understand it is aiming to publish regulations.

It is important that we get things right. On the one hand, there is no question that we should challenge the creation or exercise of power by essential facilities that is truly detrimental to consumer welfare. On the other hand, however, we must not stifle the innovation, skill, industry or foresight that frequently account for the power or chill efficient conduct by those who have won it. We will try our best.