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ANNUAL MEETING

Thursday, January 27, 2000
New York Marriott Marquis
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SECTION BUSINESS MEETING, ELECTION OF OFFICERS AND MEMBERS OF THE EXECUTIVE COMMITTEE

ROBERT L. HUBBARD, ESQ.: Good afternoon. I'm Bob Hubbard, and I have the pleasure of chairing this Section. As is my wont, I try to start meetings on time. I failed slightly in that regard today, but we'll try to move quickly so we can get to Bill Lifland's year in review and otherwise get this meeting moving.

The first order of business is our brief Section business meeting, and I would like to introduce Barry Brett, who chaired the Nominating Committee, and hear his report. Barry.

BARRY J. BRETT, ESQ.: The Nominating Committee reports as the following recommendations for officers of the Section for the year 2000-2001. As Chair, Martha E. Gifford; as Vice-Chair, Kenneth R. Logan; and as Secretary, Steven M. Edwards. As members of the Executive Committe: Kevin Arquit, Michael Bloom, Barry Brett, Ned Cavanagh, Bruce Colbath, Lloyd Constantine, Harry First, Larry Fox, Eileen Gotts, Pamela Harbour, Steve Houck, Bob Hubbard, Norma Levy, Bill Lifland, Joe Lipofsky, Steve Madsen, Bernie Persky, Bruce Prager, Steve Tuganber, Vernon Vig, Michael Weiner, Alan Weinschel and Yvonne Quinn.

That is the report of the Committee, and we would welcome a nomination, a motion to accept the report.

MR. HUBBARD: Any motion, any nominations?

SPEAKER IN AUDIENCE: Move to accept the slate.

MR. HUBBARD: Second?

SPEAKER IN AUDIENCE: Second.

MR. HUBBARD: The question is called. All those in favor.

(Audience voted aye.)

MR. HUBBARD: Opposed?

(None)

MR. HUBBARD: We will go right on to the program. I have the pleasure of introducing the Vice-Chair of the Section—well, now she's Chair, Meg Gifford—who put together this fine program. Meg.

MARTHA E. GIFFORD: Thanks, Bob. For those of you who are interested I will note that there are actually a few antitrust lawyers in New York City who are not members of the Executive Committee, despite the length of that list.

I have the great honor of presenting Bill Lifland of Cahill, Gordon & Reindel, who has for a number of years presented a program on The Annual Report of Antitrust Developments in the prior year. Bill will be presenting that report again today. We are always delighted to have his insights.

Bill was the first recipient of the Section's award for service to the Section, and we're honored to have him present this program again today. Bill.

Annual Review of Antitrust Developments

WILLIAM T. LIFLAND, ESQ.: Antitrust was very much in the news during 1999.

Monopolization

Much of the media attention was directed at the lawsuit brought against Microsoft Corporation by the Justice Department and 19 states. Most antitrust lawyers are familiar with the main findings the Court entered after the conclusion of testimony.[1] These were: first, that a relevant market existed for operating systems for Intel-compatible personal computers; second, that Microsoft held a monopoly in that relevant market, and third, that Microsoft had kept that monopoly by maintaining entry barriers which if allowed to fall would threaten the continuation of the monopoly. Although the court purported to issue only factual findings and not conclusions of law, the tenor of the findings suggests that when conclusions are made, the court will determine that Microsoft illegally monopolized that market and also that some of the agreements used for the purpose were separate violations of § 1 of the Sherman Act. In recent weeks there have been media reports that government lawyers wrestling with the question of what relief to seek have concluded that some form of divestiture or dissolution is needed.

The attention given to this case has tended to eclipse another Microsoft monopolization case which was pending in a district court in Utah.[2] In the Utah case the manufacturer of another operating system, DR DOS, sought damages for alleged unlawful exclusion from the market. The district court stated that there was sufficient evidence for a jury to find that various Microsoft actions were part of an anticompetitive scheme. These actions included exclusion of DR DOS from the beta testing of Microsoft's Windows software, the insertion of codes in the Windows software to make the DR DOS program appear incompatible, and even the integration of Microsoft's operating system with a graphical interface so as to form Windows. The court indicated a view that such integration could be found unlawful unless a valid, not insignificant technological improvement was shown to be achieved. The case has since been settled. The amount is confidential but some industry followers hve estimated it at over $200 million.

Also of significance in last year's monopolization rulings are two cases involving Intel. The FTC alleged Intel sought to maintain its dominance as a manufacturer of general purpose microprocessors by denying advance technical information to customers who were unwilling to license Intel under their own technology. In the FTC's view that advance information was "essential" to customers. The case was settled on the eve of the hearing by Intel's accepting an obligation, with some exceptions, not to withhold advance technical information from customers for reasons relating to an intellectual property dispute.[3]

One of those customers, Intergraph Corporation, obtained a preliminary injunction requiring Intel to furnish it such information during litigation it had begun against Intel asserting unlawful monopolization. The Federal Circuit, however, ruled that the injunction was unwarranted because unlawful monopolization could not be shown as a matter of law.[4] The reason given was that the customer was not a competitor of Intel. The absence of a competitive relationship, in the court's view, undercut the various antitrust theories of liability. The FTC appears to disagree, and time will tell who is right.

The court also said that the presence of a competitive relationship was fundamental to invoking the Sherman Act to force access to the property of another. This seems to be a question of standing, which need not concern the FTC as a public agency, but others might find this rule questionable, too. If the absence of a competitive relationship is a sufficient basis for denying standing, this reduces further the number of potential private enforcers with incentive to sue. The First Circuit, in dictum, has indicated that private antitrust plaintiffs may be divided into first-best and second-best, and second-best may be accorded standing when first-best lacks the incentive to sue.[5]

In a number of other 1999 monopolization cases, the main issue was whether the conduct involved went beyond competition on the merits and rose to the level of exclusionary conduct. In one case, involving a predatory pricing claim brought by a manufacturer of aircraft boarding bridges against a rival, the court applied its version of the Supreme Court's *Brooke* rule,[6] stating that a claim of predatory pricing was not established in the absence of a showing that the alleged below-cost pricing was first, of sufficient duration to force plaintiff out of the market, and second, below variable cost (this part goes beyond *Brooke* which on this point stated that the price must be below some measure of cost).

In another case, the defendant tried to use the *Brooke* rule defensively, stating that its various sales practices—such as bundled rebates—were reducible to price, and as the sales were profitable, no violation could possibly be found. The district court disagreed.[7]

Some other monopoly cases, as might be expected, turned on definition of market. In particular there continues to be litigation over whether it is appropriate to confine a relevant market to an aftermarket, that is, a market for service or parts for the equipment sold in the foremarket, and limit the aftermarket to a particular brand of products. The Supreme Court held such a narrow relevant market could exist in its 1992 *Eastman Kodak* case.[8] A market so defined usually implies a high share for the defendant. Some later courts have viewed the *Kodak* decision as limited to cases in which there was an "informa-

tion deficit" imposed by the equipment manufacturer, causing customers to believe that the aftermarket would be competitive so they would not be locked into the manufacturer for service and parts. In one such case this year, the First Circuit found that a manufacturer could not be found to have unlawfully monopolized by offering three-year warranties with the purchase of particular computers.[9] Such a warranty tends to assure the manufacturer of most, if not all, sales of service and parts in the aftermarket. The court stated that a plaintiff attempting to prove an aftermarket only relevant market must advance evidence disassociating the competitive condition in the after- and foremarkets. In the absence of doing so, the court indicated, as the defendants in *Kodak* had argued, that two markets were to be treated as one. The market participants would then include the foremarket competitors. The defendant's market share would accordingly be reduced and monopoly power might not exist. The court also commented that a three-year warranty had an obvious virtue for the user, perhaps hinting that even if monopoly power had existed, the court might have found a valid justification for the warranty.

A most unusual monopolization case involved a bond-rating agency which had published unfavorable ratings for bonds issued by a school district. The school district, in addition to claiming defamation and unlawful interference with contracts, sought to assert antitrust claims. The district court denied leave to amend to put forward these claims, and the Tenth Circuit agreed. The appellate court indicated that none of the authorities cited by the school district suggested that mere speech could constitute an antitrust violation. The argument that the publication of the rating, allegedly with the intent to exercise monopoly power, constituted a violation of the antitrust laws, was held by the court to be inconsistent with the First Amendment.[10]

Conspiracy

The decisions reported last year included a number of rulings to the effect that antitrust plaintiffs had not satisfied their burden of showing, in cases charging that parallel conduct was conspiratorial, that it was probable that the parallel conduct had been brought about by agreement rather than from separate unilateral decision. In one case, the Seventh Circuit affirmed the district court's ruling that retail pharmacies, claiming that drug manufacturers had agreed to discriminate against them, may have shown the discrimination but not the agreement.[11] The court stated that it would not be surprising for manufacturers with market power to discriminate against retailers—by giving their best prices to hospitals and other buyers able to influence usage—and that the evidence did not indicate any likelihood that they had discriminated by agreement rather than unilaterally.

In another case, the failure of evidence of agreement saved the defendant despite conduct antitrust lawyers would have strongly counseled against.[12] The case involved an alleged conspiracy among manufacturers of baby food, a concentrated industry. The evidence showed numerous discussions and communication of information with respect to prospective pricing matters among lower level representatives of competitors. Antitrust lawyers would have warned the parties that such conduct risked fines or imprisonment or both. Luckily for the defendants, however, there was a combination of factors indicating the absence of conspiracy: the individuals involved did not have pricing responsibilities, the information exchanged was sporadic, and most important, the pattern of actual price moves indicated a competitive rather than a collusive market place. Because one could never count on these save-the-day factors, lawyers are obviously justified in sticking with their usual advice to avoid such exchanges.

In a somewhat similar situation, the Sixth Circuit upheld a district court's grant of judgment as a matter of law, overturning a jury verdict of conspiracy.[13] The Sixth Circuit ruled that plaintiff's evidence of parallelism and opportunity to conspire, although consistent with conspiracy, was still not enough to allow an inference of conspiracy. The case related to a standard design for sulkies used in harness racing. The charge was that defendants conspired to choose, as a standard, an older design rather than the plaintiff's allegedly improved design. The evidence, found inadequate, indicated attendance of other sulky manufacturers at the association meetings, friendships among committee members and other sulky manufacturers, and dislike shown by certain members toward the plaintiff or its design. But the key evidence was the explanation for the action taken. The court indicated that testimony that the chosen design was preferred by the vast majority of drivers made the other evidence as consistent with non-conspiratorial as with conspiratorial actions. There was also no evidence that the defendants had anything to gain from a conspiracy.

The existence of an incentive to conspire and the nature of any explanation for parallel action have become perhaps the most important factors in a court's willingness to infer a conspiracy from parallel action. An asphalt contractor's antitrust claim charged competitors with conspiring to induce asphalt producers to withhold supplies from plaintiff. The Seventh Circuit ruled that the claim should not have been dismissed on summary judgment. Saying that the alleged conspiracy was plausible if the producers were being paid to impose the alleged boycott, the court found that there was some evidence that producers had in fact obtained higher prices from the alleged conspirators. It also noted that the reasons given for refusing to sell to the plaintiff were pretextual. The court ruled that this evidence collectively could enable a rational jury to conclude that the plaintiff was indeed the victim of a producer's boycott.[14]

In a somewhat similar situation, but on the other side of the coin, the First Circuit observed that it was highly

implausible that the defendant had any reason to embark on the alleged conspiracy since it was contrary to their collective interests.[15]

Before we leave the subject of conspiracies, it bears mentioning that there is sometimes a fine line between conspiratorial behavior and lawful cooperation and collaboration among businesses. Lawyers may find the government's proposed *Antitrust Guidelines for Collaboration Among Competitors*[16] helpful in considering such issues. Although the *Guidelines*, in their current version, are often noncommittal as to whether conduct is or is not lawful, they at least provide an analytical framework for considering the conduct, and the *Guidelines*' limited "safe-harbor" provisions may be useful in shaping advice.

Acquisitions

1999 was also a year of the mega-merger, most particularly in the oil industry. Exxon-Mobil and BP-Amoco attracted much attention, as has the pending proposed transaction involving BP-Amoco and ARCO. There are probably few antitrust lawyers whose clients have not asked them how the government could possibly be interested in their relatively modest merger proposals when they have allowed such huge transactions to proceed. The answer is, of course, two-fold: restructuring was required in both Exxon-Mobil and BP-Amoco,[17] and it is likely competitive impact, rather than absolute size, which counts. Still, it is probably not unreasonable for clients to conclude from the newspapers that there are no mergers that will not survive antitrust review if the parties are willing to take enough restructuring steps. In dealing with persons who have drawn such conclusions it may be worthwhile to refer to the statement of three FTC commissioners indicating the reasons for their decision to permit the Exxon-Mobil merger to proceed subject to restructuring. There were several grounds. First, 60% of the assets of the merged firms were outside of the United States and competitive effects in these areas had been reviewed by several antitrust authorities who had approved the transaction with some adjustments. Second, and perhaps most important, overlaps within the United States, although large in dollar volume, amounted to only about 3% of the merged assets and the overlaps would be substantially removed by the agreed restructuring. Finally, after the transaction, the industry would remain relatively unconcentrated, the top four firms accounting for only about 42% of refining capacity and gasoline sales.[18] In cases of greater concentration, higher percentage overlaps, and most important, more uncertainty about the ability of restructuring to counter potential anticompetitive impact, it is unclear whether the agencies would have allowed the transaction to proceed unchallenged. Indeed there is speculation in the trade press that the proposed ARCO transaction may be unfixable from the FTC's viewpoint because ARCO has been a "maverick" in retail gasoline pricing in the western states, helping to contain price levels in an area where prices tend to be higher than elsewhere.[19]

It is a common view that litigation to test the validity of mergers has become much less common since the Hart-Scott-Rodino Act empowers the agencies to delay transactions substantially. This is, of course, true to a certain degree, because prolonged uncertainty is a potent deal-killer, but litigation nonetheless occurs in some cases.

In one case, a customer of merged firms sought to challenge a merger not objected to by the agencies. The court indicated that the agencies' failure to move was not dispositive since they could not be expected to proceed against all improper transactions.[20] The court's comment was probably too casual; the agencies would probably say that if they allowed a transaction which violated the law, the most likely reason was that they lacked clear evidence of the violation. Unfortunately, the agencies do not generally give their reasons for inaction. Reasons are given for issuing complaints and imposing restructuring requirements, but not normally for doing nothing. It would be a great help to have these reasons.

In another proposed merger involving midwestern hospitals, the appellate court ruled that the FTC had drawn the relevant market too narrowly, thus overstating market shares. According to the court, the FTC had defined the market as essentially limited to the hospital's service areas, when in fact residents of those areas often sought competitive services from hospitals outside the area. The court said the market should include such hospitals. The FTC sought Supreme Court review, and when this was unsuccessful, dismissed the case.[21]

Exclusives

Another recurring issue under the antitrust laws is whether a supplier may lawfully require a distributor to handle its products exclusively. Section 3 of the Clayton Act could be read to treat such requirements as having special antitrust vulnerability, but in fact the recent precedents generally uphold them. Where the supplier lacks market power, the distributor's failure to prove an adverse effect on market-wide competition is generally fatal to such a claim.[22] Where the supplier in fact possesses market power, some courts have ruled that the exclusivity obligation may be both a violation of Section 3 and part of an unlawful attempt at monopolization. The Second Circuit, though, ruled in favor of a supplier charged with wooing away its competitor's distributors and binding them to exclusive distribution arrangements.[23] The key factor was the absence of barriers to entry by additional distributors. The court indicated agreement with a Ninth Circuit ruling that exclusive dealing arrangements do not clearly foreclose competition if suppliers can reach ultimate consumers through alternative channels of distribution.

State Action

An antitrust subject where particularly fine distinctions may be found is known as the "state action" doctrine, although it does not always involve much action by states. The Tenth Circuit stated the conventional doctrine in dismissing an antitrust claim of an industrial customer of an electrical utility. The customer asserted that the utility acted illegally by refusing to transmit to the customer power purchased by the customer out of state. The district court dismissed the lawsuit as foreclosed by the "state action" doctrine, since a state statute provided utilities with exclusive service territories. The appellate court agreed, saying that the Sherman Act was inapplicable if the state had clearly articulated and affirmatively expressed a policy to displace competition and had entrusted a utility commission with the duty of actively supervising the implementation of the policy.[24]

In another case, the same Circuit approved a dismissal on the ground of state action immunity when a city awarded an exclusive contract to a waste disposal company. The court acknowledged that the enabling statute did not expressly authorize exclusive contracts but said that such exclusivity was a foreseeable result of the general statutory authorization to contract for disposal services.[25]

"Foreseeability" is not always the litmus test, however. When a litigant argued to the Second Circuit that state action immunity for an exclusive contract was inappropriate because the legislature could not have foreseen the severe anticompetitive effects which would result, the Second Circuit ruled that state action immunity applies when a state law contemplates a certain type of activity, even if the activity is conducted under circumstances that magnify the anticompetitive effects which could have been anticipated.[26]

The Fifth Circuit, sitting *en banc*, reached an arguably inconsistent result. In that case, a district court was held to have incorrectly granted immunity on the basis of a legislature's general grant, to a hospital district of authority to conduct its affairs. The appellate court stated that it must be clear from the nature of the policy articulated by the state that the state contemplated a displacement of competition. Giving rights to conduct affairs did not specifically indicate a policy to displace competition. The court went on to say that federal courts could not insist that state legislatures use federally dictated words in their statutes, but the state action would be immunized from the federal antitrust law only where the language and context fairly illustrates a state policy to displace competition.[27]

Standard of Proof

A perennial issue under the antitrust laws is whether the *per se* rule or the rule of reason applies to particular conduct. Some authorities have viewed the application of the rule of reason as too cumbersome in practice. To deal with this criticism, the Supreme Court adopted the so-called "quick-look" rule of reason, which was said to be applicable in the twinkling of an eye. Now the Court has recognized that this may be too fast, at least in some cases. This was illustrated by the Court's 1999 decision involving an association of California dentists.[28] The Court ruled that the Ninth Circuit had moved too quickly, that is, had failed to perform an adequate competitive analysis, when it upheld the FTC's conclusion that the Association's rules against false and misleading advertising were applied so as to restrict non-deceptive price and quality advertising. The Supreme Court said that the anticompetitive effects of the restrictions were not intuitively obvious, and the rule of reason accordingly demanded a thorough inquiry into the consequences of these restrictions. The "quick look rule of reason" was not enough. Observing that the restrictions at issue barred unverifiable claims—such as claims as to quality of service, or price comparisons not based on substantiating data—and were far from a total ban on quality or price advertising, and might promote competition by reducing the occurrence of unverifiable and misleading advertising, the court ruled that further analysis was needed. A fair question for the majority might be: Suppose anticompetitive effects were intuitively obvious. What then? A possible answer might be that in that case a *per se* rule was to be applied. That provokes the further question: What use is there for a quick-look rule if the *per se* rule is applied when effects are obvious and the full rule of reason is applied when they are not? Possibly there is an intermediate category, but it may be hard to locate precisely. Litigants may be wise to play it both ways in offering their proof.

The Supreme Court's decision may have been foreshadowed by a Second Circuit ruling that a no-switch agreement in which two employers agreed not to hire each other's employees was not *per se* illegal.[29] Stating that a harmful effect on competition was not clearly apparent, the court viewed the case as inappropriate for *per se* treatment. This is not to say, of course, that numerous practices such as price-fixing or market division are also to be removed from the *per se* penalty box. At the same time, the fertile imaginations of entrepreneurs can produce arrangements which defy categorization in accordance with traditional *per se* rules. It makes sense to evaluate these arrangements under the rule of reason. For example, in a Seventh Circuit decision last year, a generator manufacturer had a subcontractor make smaller units under its trade name and permitted the subcontractor to sell them to its dealers, paying an "access fee" to the manufacturer.[30] The subcontractor was not permitted to sell larger units to the manufacturer's dealers or to sell other generators in the dealers' territories.

Some might classify this type of arrangement as horizontal. That is exactly what the subcontractor did when the manufacturer terminated the arrangement, and the subcontractor sued. It challenged the arrangement under

which it had been operating for several years as a horizontal market division violating § 1 of the Sherman Act. The appellate court instead categorized the agreement as a vertical one, pointing out that it involved the transfer of the manufacturer's trademark rights to the subcontractor in exchange for assuming certain restrictions. Accordingly, since the arrangement was classified as vertical, the rule of reason applied and the subcontractor lost. The court said that in a rule-of-reason case the plaintiff must show an anticompetitive welfare-reducing effect, but had not given any credible account of lowered output or increased price.

Some of us might have found it more satisfactory to base the dismissal simply on the absence of evidence of such anticompetitive effects, without regard to whether the arrangement was horizontal or vertical. That of course is difficult under current doctrine if horizontal market division is always to be analyzed under a *per se* rule.

Arbitration

A final word about remedies. It has become increasingly common for contracts to include clauses providing for compulsory arbitration of all disputes arising under the contracts, even antitrust disputes. Such clauses may well be enforceable even though it is uncertain whether the arbitrating tribunal will apply U.S. antitrust law. The Ninth Circuit ruled that such a clause was enforceable in a dispute between two designers of automotive air bags.[31] One party sought to avoid arbitration, stating its concern that a Swiss tribunal would not apply U.S. antitrust law. The party argued that the Supreme Court had stated that contracts purporting to waive remedies for antitrust violations were against public policy. The Ninth Circuit treated the Supreme Court's statement as non-binding dictum, and indicated instead that a choice of law clause should be enforced unless the transferring court's law was so deficient that a party would be deprived of any reasonable recourse. While this decision leaves open some basis for resisting arbitration of contract-based antitrust issues, it seems likely that the trend of the law will favor having those issues, along with others, decided by arbitration when the parties so agree. This raises the question whether parties may find it useful, if arbitration is to include antitrust disputes, to choose the governing law as to such disputes, and perhaps why that choice is appropriate. Antitrust disputes are often over matters of public policy, so the choice may not stick. But where a dispute is really over the private interests of the parties, they should have a greater latitude in establishing reasonable means for their resolution.

Endnotes

1. *U.S. v. Microsoft Corp.*, Findings of Fact, CCH Trade Reg. Rep. ¶ 50,173.
2. *Caldera, Inc. v. Microsoft Corp.*, 1999-2 CCH Trade Cas. ¶ 72,703 (D. Utah); see also earlier ruling at 1999-2 CCH Trade Cas. ¶ 72,725.
3. CCH Trade Reg. Rep. ¶ 24,575.
4. *Intergraph Corp. v. Intel Corp.*, 1999-2 CCH Trade Cas. ¶ 72,697 (Fed. Cir.).
5. *Serpa Corp. v. McWane, Inc.*, 1999-2 CCH Trade Cas. ¶ 72,724 (1st Cir.).
6. *Stearns Airport Equipment Co. v. FMC Corp.*, 1999-1 CCH Trade Cas. ¶ 72,490 (5th Cir.); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 1993-1 CCH Trade Cas. ¶ 70,277; 509 U.S. 209.
7. *LePage's Inc. v. 3M*, 1999-1 CCH Trade Cas. ¶ 72,538 (E.D. Pa.).
8. *Eastman Kodak Co. v. Image Technical Services*, 1992-1 CCH Trade Cas. ¶ 69,839; 504 U.S. 451.
9. *SMS Systems Maintenance Services Inc. v. Digital Equipment Corp.*, 1999-2 CCH Trade Cas. ¶ 72,617 (1st Cir.).
10. *Jefferson County School District v. Moody Investor's Services*, 1999-1 CCH Trade Cas. ¶ 72,509 (10th Cir.).
11. *Brand Name Prescription Drugs*, 1999-2 CCH Trade Cas. ¶ 72,576 (7th Cir.).
12. *Baby Food Litigation*, 1991-1 CCH Trade Cas. ¶ 72,396 (3d Cir.).
13. *Super Sulky Inc. v. United States Trotting Association*, 1999-1 CCH Trade Cas. ¶ 72,487 (6th Cir.).
14. *JTC Petroleum Co. v. Piasa Motor Fuels Inc.*, 1999-1 CCH Trade Cas. ¶ 72,562 (7th Cir.).
15. *DM Research Inc. v. College of American Pathologists*, 1999-1 CCH Trade Cas. ¶ 72,469 (1st Cir.).
16. CCH Trade Reg. Rep. ¶ 50,172.
17. *Exxon-Mobil*, CCH Trade Reg. Rep. ¶ 24,677 (FTC) BP-Amoco, CCH Trade Reg. Rep. ¶ 24,550 (FTC).
18. CCH Trade Reg. Rep. ¶ 24,677.
19. FTC WATCH No. 536 (Jan. 17, 2000) pp. 1-2.
20. *AlliedSignal, Inc. v. B.F. Goodrich Co.*, 1999-2 CCH Trade Cas. ¶ 72,564 (7th Cir.).
21. *FTC v. Tenet Health Care Corp.*, 1999-2 CCH Trade Cas. ¶ 72,578 (8th Cir.).
22. *Anheuser-Busch Inc. v. G.T. Britts Distributing Inc.*, 1999-1 CCH Trade Cas. ¶ 72,511 (N.D.N.Y.).
23. *CDC Technologies, Inc. v. IDEXX Laboratories Inc.*, 1999-2 CCH Trade Cas. ¶ 72,594 (2d Cir.).
24. *North Star Steel Co. v. MidAmerican Holdings Co.*, 1999-2 CCH Trade Cas. ¶ 72,583 (2d Cir.).
25. *Southern Disposal Inc. v. Texas Waste Management*, 1998-2 CCH Trade Cas. ¶ 72,356 (10th Cir.).
26. *Omega Homes Inc. v. City of Buffalo*, 1999-1 CCH Trade Cas. ¶ 72,483 (2d Cir.).
27. *Surgical Care Center of Hammond v. Hospital Service District No. 1*, 1999-1 CCH Trade Cas. ¶ 72,482 (5th Cir.).
28. *Calif. Dental Ass'n v. FTC*, 1999-1 CCH Trade Cas. ¶ 72,529 (Sup. Ct.).
29. *Bogan v. Hodgkins*, 1999-1 CCH Trade Cas. ¶ 72,428 (2d Cir.).
30. *Generac Corp. v. Caterpillar Inc.*, 1999-1 CCH Trade Cas. ¶ 72,485 (7th Cir.).
31. *Simula Inc. v. Autoliv Inc.*, 1999-1 CCH Trade Cas. ¶ 72,512 (9th Cir.).

MS. GIFFORD: Thank you to Bill for another concise and pithy review of the year that we've just been through, and we're grateful to him for doing this for us on such a regular long-time basis.

By the way, Bob Hubbard said that I put today's program together. Let's be clear about this. The program moderators put today's program together. And beginning not later than 2:00, and maybe a minute or so early, we will begin our second part of today's program.

Harmonizing Intellectual Property and Antitrust Law

BARRY J. BRETT, ESQ.: We have a great challenge confronting this panel for the next couple of hours. It starts with having to follow Bill Lifland, and then it continues with having to deal with harmonizing intellectual property law and antitrust law within two hours. But we've got the group that makes it worthwhile to give it a shot. We're lucky in the scheduling of the program that the timing of the Microsoft litigation and other current events makes these issues particularly timely, and we're able to focus current events on the antitrust principles affecting the development, use and opportunities of the rapidly changing intellectual property rights. And while this is not going to be a Microsoft program as such, we have some people with us who can discuss that case as illustrative of the issues that are raised when the exploitation of intellectual property rights intersect with antitrust law.

Let me just very quickly tell you the format that we are going to use and you will then be able to hear from our speakers. I will introduce all four panelists now in the order of their presentation. After we hear from our four speakers we will invite questions and discussions from the floor. If any questions occur to members of the audience as we're moving forward, if you'd like to bring them up or hand them up, we can make sure that they get put together and that they do get focused on, but we'll certainly invite members of the audience to participate directly.

The first speaker we are going to hear from this morning will be Steve Houck. Now, I'm not going to tell you the year Steve graduated from Harvard Law School, because I met him shortly after that in litigation. I don't want you to know how old he is. But Steve has been a partner at the Donovan Leisure firm, and he served with distinction as Chief of the Antitrust Bureau of the New York State Attorney General, and he also served with great distinction as the Chair of this Section. While he has a long list of credits, most recently he was the lead trial counsel of the 19 state plaintiffs in the *Microsoft* case. And I'm pleased to tell you, if you've not otherwise heard, Steve has just announced that has has become a partner in the Reboul, MacMurray firm and will be rejoining us among those who defend the good.

After Steve we will hear from Alan Weinschel of Weil, Gotshal. Alan received his law degree from NYU, and he is a recognized author on issues relating to intellectual property. You will hear during the course of his presentation about the book that he is about to issue on the program. Alan is a practitioner of great distinction, and a good friend of many years. He is a past Chair of the Section, and his work in this area makes him one of the leading spokespersons on the issues that we are going to be confronting.

Our third speaker is Jay Simon who is Assistant General Counsel of Exxon-Mobil Research and Engineering. Jay has a bachelor's degree in chemical engineering at CCNY and received his legal training at NYU. Jay lectures widely on patent licensing and related issues. I first met him when I attended one of his lectures, and I was extraordinarily impressed with the manner of his presentation and his ability to give us the unique perspective of a practitioner dealing with these issues on the firing line day-to-day in doing licensing for a large company, which has to confront how to license and how to maximize its intellectual property without violating the antitrust laws.

Now I'm particularly pleased to introduce our fourth speaker, Bob Hall. Bob is with us today to discuss these issues with particular reference to his work on Microsoft. We have a number of people to thank for Bob's presence, certainly Analysis Group for which Bob is an academic affiliate. They prevailed on him to leave California to come walk around in the snow and cold in New York to share his insights with us, and that really is perhaps above and beyond. Bob's credentials in the area are extraordinary. He has a Ph.D. in economics from MIT; he has taught economics at MIT and Berkeley. He is now professor of economics at Stanford and a senior fellow of the Hoover Institution.

The writings and testimony and activities of Bob are listed in the program materials. His work in Microsoft and related areas are of great note and regularly quoted. You may have seen, if you've been reading the articles about Microsoft, how frequently Bob is the expert and person to whom the press and others will go for comments and how he leads those and has observations on what's going on in the area.

So without any further introduction and discussion, Steve will begin our program.

STEPHEN D. HOUCK, ESQ.: Thank you, Barry. I'm not as hesitant about my age as Barry is. I graduated from law school in 1972 and was a very young associate in the law firm working on a case against Barry, and he was a very senior partner in the firm he was at at the time.

Barry has asked me to talk about market power and high-tech industries. Specifically he's asked me to talk about proof of market power in the *Microsoft* case and the implications of market power with respect to relief there, which is the issue du jour. As you all know, *Microsoft* is presently before the mediator, Richard Posner, and perhaps ultimately—unless Professor First, my

successor at the Antitrust Bureau, is able to settle the case—will be back again in Judge Jackson's court.

How to deal with market power in high-tech industries is a very intellectually interesting and challenging problem for antitrust courts. It's also enormously important. As you know, market power is a critical element of many antitrust offenses, including § 7 cases, various § 1 cases and, of course, § 2 cases like *Microsoft*. It is absolutely critical that courts analyze market power issues correctly in high-tech cases because of the enormous importance high-tech industries have to our economy today.

Seemingly overnight, new companies like AOL and Microsoft have amassed enormous market power and wealth, eclipsing and even taking over more established companies in their own right. Competitors have been forced to the margins and sometimes even to the sidelines. The startling success of these companies is attributed to newly identified phenomena that some of my fellow panelists no doubt can talk about better than I, such as network effects, tipping, lock-in, positive feedback loops and the like. Some, however, argue that this concentration of market power in high-tech industries, which is very often derived from intellectual property, is not something courts need worry about; that it can dissipate just as quickly as it arises with the next shift in technology. In the not-too-distant past, courts tended to presume from the mere possession of intellectual property market power. Now it seems in many cases it's the opposite that's almost true.

My own personal view is that market power is market power, whether derived from physical assets in smokestack industries or from intellectual property in high-tech industries. To be sure, market power must be considered in the context of the industry in which it arises. That the industry happens to be high-tech may or may not be of relevance. In short, the appropriate analysis, as it always has been in antitrust cases, is intensively fact-based.

The bad news is that one cannot escape the hard work and fact-gathering analysis simply by invoking the magic words high-tech. The good news, as I think the *Microsoft* case shows, is that traditional antitrust analytical tools retain their value in high-tech cases. And as the *Microsoft* case shows, they can be applied relatively quickly and most assuredly to reach the right result.

Proof of market power in *Microsoft* started as it does in virtually any case, rather mundanely with market definition. The reason is obvious: one can't measure a company's market power without first defining the market in which the company competes. Using traditional principles of market definition—supply and demand substitutability—the government economists define the relevant market for purposes of the monopolization claim in *Microsoft* as the one for Intel-compatible PC operating systems. I should note most of the economic testimony in market definition was presented by the state's economic expert Rick Warren-Boulton, and I would be extraordinarily remiss if I didn't point out that he was examined at trial by the Deputy of the Antitrust Bureau, the Deputy Chief, Richard Schwartz, who is in the audience today.

To say that market definition can be crucial is no exaggeration. As is often true in merger cases, the market power battle often turns in large part on how the market is defined. If you take a look at government Exhibit 1, which is one of the many exhibits all over the Internet, you will see what I mean. Government Exhibit 1 portrayed Microsoft's market share assuming the market was defined, as government's economists said, as the market for Intel compatible PC operating systems, at levels of close to 90% or over 90% for more than a decade. So it demonstrated, I think very clearly, and was something I used in my closing argument to emphasize the point that Microsoft's market power, even though this was a high-tech industry, was not only exceptionally high but was extraordinarily durable for many, many years.

The reason for Microsoft's market dominance, as considerable evidence at trial established, lies in the existence of the so-called applications barrier to entry, which is again something unique to this market and why it is so important to get down and dirty with the facts. The applications barrier to entry is a reference to the number and variety of Windows-compatible applications that make Windows Microsoft's operating system a virtual necessity for most PC users. There is no demand substitutability, which makes it virtually impossible for other operating system vendors to get even a toehold in the market. And there is no supply side substitutability.

The government case on market power was supported by much additional evidence which is alluded to in the findings of fact issued by the court in the market power section, which, if you're interested, is in the first 35 pages of a rather massive tome issued by Judge Jackson. But a few examples will give you some flavor of the kind of evidence the government put forward on market power and market definition. One was an internal Microsoft document written by a very high-level Microsoft executive in which he described the market exactly as a government's economist did, as one for PC-compatible operating systems, and the market share figures he gave in his analysis were virtually identical to the government's. Another was a Microsoft e-mail showing that Microsoft set the prices for Windows virtually without any consideration of, certainly no concern about, the prices of any other operating systems in the market. There was also testimony by any number of OEMs, that is, computer manufacturers, that they simply could not sell their PCs unless they contained a Windows operating system. And in the same vein, there was testimony

by an IBM executive who had been negotiating with Microsoft, and he testified that the Microsoft executives told him they had no reason to discuss prices with him because, as they put it, Windows was the only game in town.

From a litigator's perspective, perhaps the most interesting aspect about the case on market power was the dilemma it posed for Microsoft's trial team. For example, rather than positing an alternative market definition, as is often the case in merger cases, the Microsoft economist simply refused to define a market for Microsoft. He said it was impossible. Now, in my view that position ultimately severely undermined his credibility, but to be fair to Microsoft, it may be they really had not very many alternatives given the market dominance they had. For example, one plausible alternative market definition was to include the Mac line of computers and products in the market, but doing that really wouldn't have helped them because even if they had been included, Microsoft still would have had market share numbers well in excess of traditional monopoly levels.

What do the court's findings on market power imply for relief in Microsoft? Well, market power is obviously a very significant part of the equation in assessing what relief is appropriate. One also must consider, of course, the anticompetitive conduct found by the court, which as you know is quite extensive.

A good starting point for examining the complex question of relief in Microsoft as it is in any case is the relevant legal authorities. The last occasion the Supreme Court had to address in any detail the subject of relief in § 2 cases was its *United Shoe* opinion in 1968. There the court emphasized that an effective remedy is one that contains the exercise of market power. Reaffirming its language in *Grinnell* the court stated that: "Relief in a Sherman Act case should break up or render impotent the monopoly power to be found in violation of the act." As Justice Fortas wrote for a unanimous court, and I quote him again: "In a Section 2 case, upon appropriate findings of violation, it is the duty of the court to prescribe relief which will terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, ensure that there remain no practices likely to result in monopolization in the future." Although somewhat dated, that's pretty strong language, and it's still pretty good law. Professors Areeda and Turner state in their treatise: "The cases seem to say that monopoly, to which plainly exclusionary conduct appears to have made a significant contribution, is itself unlawful in that it is the duty of the court to assure its complete extirpation."

Now, should it make any difference in fashioning relief that the property used by the defendant to commit the violation is intellectual in nature rather than physical? I think not. It would be perverse, in my view, to permit anticompetitive conduct to be shielded by an assertion of purported rights in the very intellectual property used to commit the violation. Intellectual property rights are, after all, limited rights conferred largely for the purpose of encouraging innovation and should not be allowed to trump the antitrust laws, which as you all know are the fundamental public laws underpinning our economy. In a room full of antitrust lawyers that is like preaching to the choir. But perhaps Alan or other members of the panel will disagree with me.

If I'm right, it follows a fortiori I think that intellectual property, like any other form of property, whether it is used for anticompetitive purposes should be potentially—and I stress potentially—subject to divestiture, forced licensing or whatever relief is necessary to accomplish the goals outlined by Justice Fortas in *United Shoe*. Any other result risks turning the rationale underlying the grant of intellectual property rights on its head, permitting intellectual property to be used to suppress rather than to encourage innovation.

Just a few words about innovation. Innovation was a mantra used by Microsoft throughout the trial against the government. Microsoft's assertion was that they were the innovators, and the government was simply being hostile to innovation and unwilling to accept the realities of the new marketplace. In fact, in his opening statement, John Warden, lead counsel for Microsoft, referred to me and other government prosecutors as Luddites, simply opposed to innovation for the sake of being opposed to innovation. And in my closing argument I tried to turn that around and argue that really what the Microsoft case is about at its heart is innovation, and it was about Microsoft's effort to suppress innovation, to suppress innovative technologies like Netscape's web browser and Java's language, which are intellectual property. Much of the anticompetitive conduct can only be understood in that context as Microsoft using its market power and its monopoly to suppress innovation that threatened its core products. And Microsoft was willing, I believe, and I think the court agreed with us in its findings, to allow innovation only when it was non-threatening to Microsoft.

Now the type of relief being discussed in *Microsoft* falls broadly into two categories: conduct relief and structural relief with many variants of each. Without getting into all the details of the pros and cons of the various proposals—and it's a very complicated question—I think it's fair to say that a key consideration in assessing the effectiveness of any remedy is, as Justice Fortas suggests, the extent to which it thwarts the continued exercise of market power. A conduct decree might be able to accomplish this but perhaps only at the expense of very highly regulatory provisions which require continuing governmental oversight and judicial involvement, which is probably not something anyone wants.

On the other hand, some forms of structural relief may have very little impact at all in dissipating market power, as for example, so-called functional divestiture which some people have proposed. This is a divestiture which would break up Microsoft into an operating system company, an applications company and perhaps a web company. And I think the problem with that kind of approach is that it leaves intact in one company, the operating system company, the monopoly power which was really at the heart of this case. Now other forms of structural relief, like the so-called Baby Bills proposal, which is cloning Microsoft into three separate companies, do provide instant dissipation of market power but they may have certain negatives as well. One principal negative advanced by people opposed to a Baby Bills-type proposal is that it will fragment standardization. That is, it will break up the standards that Windows has set by its sheer market presence, which they argue is something that would be detrimental to consumers and to other industry participants. I for one don't view that as too much of a concern, because I think given the enormous base that now exists of Windows-compatible applications it would be virtually suicidal for any one of the cloned companies to not keep their operating systems compatible with that enormous base of applications.

As I've said, the subject of relief in *Microsoft* is intriguing and challenging, and I look forward with you to hearing what the other panelists say and, probably more to the point, to see how the court ultimately deals with it.

ALAN J. WEINSCHEL, ESQ.: I do have a book coming out this year, but Letterman wouldn't take me because he's on reruns, and I wasn't interesting enough. So here I am. But the book really has very little to do with what I'm going to talk about today.

I'm going to talk about *Microsoft* and relief. And I do disagree with Steve. I'm not quite so sure about what kind of relief ought to be entered in cases like this. I have a lot more uncertainty. I think that that's reflective of the way the law has developed in this area, which has been somewhat schizophrenic about innovation and antitrust. I don't think the courts are terribly sure of what to do, and in *Microsoft* the government hasn't won yet. There are findings of fact which most people think favor Microsoft. I think I'll show you some that aren't so terrific for the government. This case is not over. The D.C. circuit may not be as hospitable as the judge, and I'm not sure it is going to settle so easily because the issues are very difficult. So let's just go back in time a little bit and try to do what this program was supposed to be titled, which is "Harmonizing Intellectual Property and Antitrust Law."

Obviously there is a kind of inherent conflict between antitrust and intellectual property, because we have a statutory distrust of monopoly, and patents do grant a form of monopoly. And as we'll see, the courts have been absolutely silly in some of their analyses of some of these issues, particularly when it comes to determining whether market power is present—in using labels—rather than vigorous analysis. I think we can agree that we have to have a system that rewards innovators. That's the patent system. And by the way, the patent system is constitutional in dimension, not just statutory, so when we talk about which system ought to trump the other, it is not so easy. Although we in this room, as antitrust lawyers, like to think that antitrust ought to trump everything; it is not so clear that it should always trump everything. Our solutions aren't always the right solutions, and from an antitrust standpoint we like to proliferate innovation. We like to see as much innovation as possible because that's clearly an element of competition.

Now, let's see some of the things the courts have done. In 1966, which is not that long ago, the United State Supreme Court looks at a patent antitrust issue in the *John Deere* case, and the court goes back through a history of the patent system in the United States, including the notion that Thomas Jefferson was the first Commissioner of Patents, and then says, astoundingly, that Jefferson, like other Americans, had an instinctive aversion to monopolies, and it was a monopoly on tea that sparked the American revolution, and Jefferson didn't favor an equivalent form of monopoly under the new government, meaning patents ought to be constrained. Well, I've never seen the framers' intent used before in quite this way in an antitrust case, and it is obvious to me not a particularly rigorous economic argument the court is using here, but rather a simple catch-word argument that says, well, "patent" equals "monopoly." We don't like a monopoly and therefore we are going to do something about it. There are other cases like that. Of course, there are also cases to the contrary.

The *Walker Process* case says the mere allegation of a patent monopoly is not enough, that you have to prove an economic market. I won't go through the intricacies of that case other than to say it is still good law. The intellectual property guidelines that were published by the FTC and the Department of Justice clearly reject the notion that a patent (or copyright or trademark) automatically confers monopoly power. And § 271(d) of the Patent Law rejects the notion that where a misuse defense is based on tying a patented product with an unpatented product, the fact that there was a patented product was sufficient to prove market power for purposes of a tie. Rather, you have to prove an economic market, and market power.

On the other hand, we have *International Salt*, another Supreme Court case, which presumed market power on the part of patented salt machines that International Salt was trying to tie salt to. And the *Paramount Pictures*

case, which presumed that copyrighted motion pictures conveyed market power to the licensors of motion pictures. And then we have the "maybe," which is *Jefferson Parish*, which says there's a presumption, and I have to presume that the presumption is rebuttable. So perhaps this is simply a matter of litigation tactics of who gets to go first rather than substance. But in any event, the law hasn't been particularly consistent.

In dealing with whether the intellectual property laws or the antitrust laws ought to govern, the agencies as well as the courts have been completely inconsistent. In 1975, we had the agencies publish their famous Nine No-No's, and I've listed them. I don't think I'll go through them in any great detail, but all of these practices were seen as virtually *per se* unlawful by the Department of Justice in 1975. So under this theory, antitrust wins and patent loses.

In the *General Electric* case, another earlier Supreme Court case, much earlier than the Nine No-No's, General Electric held patents on light bulbs, licensing the patents to Westinghouse on the condition that Westinghouse use the same consignment system and charge the same prices that GE charged for the bulbs that GE was selling. Most of us would not counsel our clients today to do that, but the Supreme Court said, well, that's perfectly within GE's patent rights; all GE is doing is exploiting the rights that were granted to it by statute, and therefore you can't attack GE under the antitrust laws for doing that which the patent laws allow it to do. GE could have charged monopoly prices for the light bulbs and instead we simply have two sellers at the same price, ergo no real effect on competition. Patent laws win.

Patent laws won under the Reagan administration as well—by default—because there was a *laissez-faire* enforcement attitude. By that time, the DOJ had repudiated the Nine No-No's, had determined that they were "more erroneous than correct" and then proceeded to say that everything was up in the air and subject to the rule of reason but brought no enforcement actions at all, which led people to believe that the Nine No-No's were now nine yes-yes's. So patents win under the *laissez-faire* theory. Where we are today, which I think is the right place, is that neither wins. We try to balance them out. We don't have a presumption of market power. Intellectual property is treated like any other asset. That's clear from the IP guidelines which are fairly reflective of the state of the law. The rule of reason generally governs. Licensing is generally procompetitive. Reasonable restrictions in licenses can actually promote licensing and promote the proliferation of inventions. And restrictions on licensing can actually produce an increase in innovation and an increase in output, which we all know is a good result from an antitrust standpoint.

I'm going to go through the *Microsoft* case because it is perhaps indicative that new incantations and new catch words are being used. However, in the IP guidelines the government has used innovation markets as a concept. Innovation markets in the sense that R&D itself can comprise a market that ought to be attackable under the antitrust laws. It has some theoretical weaknesses because it's not quite clear from an economic standpoint, and there's lots of literature on this, that decreases in research and development or decreases of expenditures for development have any measurable effect on products down the line. There are efficiencies to be gained from conglomerations of research and development. And in fact, one of the interesting things here and another inconsistency is that the IP guidelines, which use specifically the term "innovation markets," also tell us that they don't apply to mergers. But the innovation market concept has essentially only been applied to mergers, and only in those circumstances where it's quite clear that there was some product down the line or that the companies involved were close enough so that there was at least evidence that there were going to be products down the line. And if you look at the cases that have come down, with the possible exception of the *General Motors-ZF* case, which had its own unique facts about geographic markets, most of the cases that have been brought have been against pharmaceutical companies, because you can tell from FDA applications what products are in the pipeline. If there are only two research efforts that are ongoing to attack a particular disease, the government has forced divestitures in those circumstances. Of course, there's been no judicial testing of this notion. Most of the time these are labs that are a small part of a very large transaction. Nobody is going to have a fight about eliminating a few scientists when you're dealing with a transaction that's worth several billion dollars. So we have no judicial testing of the innovation market concept. Nobody, for example, has examined whether combining two research and development efforts might lead to the faster introduction of a new drug rather than the slower introduction of a new drug. So I think, to some extent, this is just a label that somebody has tacked onto a particular species of potential competition case in the interest of applying antitrust to intellectual property issues.

Now to Microsoft. I agree with Steve that Microsoft has tried to use "innovation" as a shield, arguing that I'm an innovator and therefore I'm exempt from the normal antitrust rules. After all, look at what I've done to expand the market through innovation. I've got DOS and I had Windows and I've got all of these great applications and the OEMs are humming along very nicely and PCs have proliferated and I've been one of the engines that has caused that, and leave me alone. I don't think that cuts it either, since that's just another form of labeling that really doesn't get us very far.

Now, let's talk about Microsoft in more detail. I don't have any vested interest here. I have no representation of Microsoft in my background or foreground.

I think the news reports may have prematurely buried Microsoft. I am not sure that Judge Jackson's findings don't have substantial pieces that are going to be picked up by the D.C. Circuit and thrown back at the government. I'll go through a few of those, just to raise some of the reasons why I'm not so sure about how this is going to play out. And I'm not so sure that the structural remedies that Steve is talking about are actually the right remedies.

Obviously the market power issue was litigated hard. Frankly, I'm not sure why it was litigated so hard, because I think it was likely a loser from day one for Microsoft. Whether the operating system and the browser could be separate products is another market definition issue, and in light of the facts it is hard to see how Microsoft could have thought it could win that issue. But that's only a piece of the analysis. Sure, they have market power in the operating system, but how did they get it, and then how did they use it, and what kind of effects occurred as a result of that monopoly power. And that's where I think there are an interesting number of things going on. First, we have exclusive dealing effects. Foreclosing Netscape by forcing OEMs to take Internet Explorer, by forbidding its removal (which Microsoft, by the way I've just noticed in their recent filing, is defending on the basis of its copyright in the program—that you can't take pieces of my program, just like you can't take pages out of a book when you're selling it). Another alleged foreclosure effect is at the Internet access provider level by promoting Internet Explorer to subscribers (that's the arrangement with AOL primarily), and also at the Internet content provider level by forcing content providers to use the Internet Explorer structure rather than the Netscape structure. But let's see what happened. Microsoft didn't always succeed, and there are findings to that effect, (although they appeared to succeed a lot more than they failed).

What is the competitive impact of exclusive dealing? The court says Netscape was foreclosed from important distribution channels, but Judge Jackson, who, you know, saw all the evidence, found insufficient evidence on Internet content providers, (and as we'll see that's extended to others)—that there had been any discernible deleterious effect on Netscape Navigator's usage. So we don't like what Microsoft did, but the question is what are the effects of what it did? We certainly don't like how they characterize what they were doing (the aggressive e-mails), but what is it that they did?

On tying, there was a finding that there was a tie between the operating system and the browser, but also a finding that consumers benefited from the providing of web browsing functionality with the OS at no additional charge. Obviously there's also a finding—which I'll talk about later—that Microsoft could have provided those consumer effects by distributing the browser separately as well as bundling it. But there was a finding of real consumer benefits to what Microsoft did, and this finding, in particular, I think is going to be thrown back at the government in the D.C. Circuit.

Microsoft's actions, found Judge Jackson, contributed to "improving the quality of web browsing, lowering its cost, increasing its availability and thereby benefiting consumers." Now, the D.C. Circuit may have a different view of whether what Microsoft did in bundling was unlawful. Its earlier decision simply said that if there was "any plausible consumer benefit" to putting the two products together, that you couldn't have a tie. That may have gone a little too far. But even if it didn't, I think the D.C. Circuit is likely to pick up on the consumer benefit issue if it wants to narrow what happens as a result of this case. There were also findings that users were burdened with a browser that degraded OS performance, and that Microsoft could have offered the same benefits by offering it separately. Here is where I think the D.C. Circuit is going to really have a problem, because this is exactly the kind of issue that the D.C. Circuit said the courts are peculiarly unsuited to making the technological call to whether this was a good thing or a bad thing for consumers, once you get past the point that there's some plausible benefit.

Suppose, for example, that including the browser as part of the operating system actually made it run faster; suppose it made it more stable. All the effects that the government alleged would have been identical, but now we would have a situation where there are clear consumer benefits from putting a browser into the operating system. It is arguable that what the findings really are saying is that Microsoft clumsily bundled the browser in the operating system. Had they done a better job, they could have escaped antitrust liability. That's where these kinds of issues go.

As OEM manufacturers, one of the findings says that Netscape really wasn't so badly affected. Bundling Explorer with Windows had no effect on the distribution and promotion of browsing software by IAPs, that's America Online, or through any of the other channels that Microsoft sought to preempt by other means. So the real problem I think the court saw was not so much present effects but a look at the future. It was looking at the "applications barrier to entry" that Steve mentioned and which clearly figures prominently in Judge Jackson's findings. In other words, if Microsoft had not done what it did, then maybe at some point in the future we'd have a better chance at having applications run independently of the operating system, and that means the operating system becomes less important. One possibility was the notion of a Netscape browser with Java language running applications from the Internet. My view is that this is speculative: as long as the bandwidth that's out there is primarily dial-up bandwidth, few would tolerate running applications over telephone lines. Perhaps this is an issue two or three years from now when people have

DSP and cable or other high-speed connections, but it's not necessarily an issue that had any discernible effect looking backward and perhaps not in the near term future. It's a rather long-term prediction about what might have happened because this was the court's problem: "Microsoft has retarded and perhaps extinguished the process by which the middleware technologies could have facilitated the introduction of competition." Of course there's no indication that would have happened "but for" Microsoft's conduct. But maybe at some point in the future it could happen if Microsoft hadn't behaved the way it behaved.

I have some further questions here. If this were a private case, for example, by Netscape, would Netscape have been able to show competitive injury by reason of an antitrust violation? I'm not so sure, based on the findings that I've just shown you. Netscape's market share is still pretty high and I'm not sure that Microsoft was in danger of monopolizing the browser market. That would be a fact issue that would be hotly contested in a suit by Netscape. Netscape obviously didn't bring a case. It did complain, and the government took up, to some extent, its cause, although I don't attribute helping out Netscape as the sole government motivation. I think there was a genuine effort to try to help out the consumer.

What are the implications for relief? I'm not sure. I'm not sure whether the browser model with applications running from the Internet via Java and Netscape is really the model that was or is ever going to develop. And I'm not so sure that a structural remedy is going to make things better rather than worse. In my view, and I suppose this will reveal that I am a *laissez-fairist* at heart, is that you don't muck around with structural relief in a market unless you're sure that you're going to make it better. And it is not enough to say that we are going to punish Microsoft for all of those e-mails. And I agree, they really ought to be punished somehow for the e-mails.

But the real issue is whether the consumer is going to be better off with three Microsofts. Is the consumer going to be better off with Microsoft broken up into three pieces? Is this market going to be better off? This is a very important market for the U.S. economy. PCs and the Internet have revolutionized the way business is done. And we'd better be sure we are doing the right thing with our remedy, or we are going to have serious economic consequences. I don't have that antitrust lawyer's hubris that says "we know best." So I'm not sure about structural remedies unless I am absolutely certain, absolutely certain that A) they are absolutely necessary; and B) they are going to make things better and not worse. Others may have a different viewpoint, but that's how I feel.

Now five minutes on Intel. Here we have a completely different case that centers around the other part of the "Wintel" monopoly, and that's Intel microprocessors, and the FTC and the Intergraph case against Intel are instructive. Bill Lifland alluded to this in his survey earlier today. Intergraph is a computer OEM, and they received technical information from Intel, through what could be characterized as a strategic partnership, as did hundreds of other OEM PC companies. Intergraph was not a competitor of Intel but a computer manufacturer. Intergraph, however, had some microprocessor technology of its own that was called the "Clipper" technology. Intergraph sued some Intel customers for infringement, alleging they were infringing its clipper chip technology. Compaq and some other PC manufacturers went to Intel and said they were entitled to indemnification from Intel. Intel tried but could not reach an agreement with Intergraph on a license. So Intergraph sued for infringement in the District of Alabama and sought to enjoin Intel from the use of Intergraph's patents, which Intergraph said were inherent in every microprocessor that Intel sold. Intel said, "Guess what, you're not my pal anymore. I'm not sending you this technical information anymore. You're not a strategic partner. You are now a litigation adversary. Goodbye."

Intergraph then amended its complaints and asserted an antitrust claim against Intel for refusing to deal with it in alleged furtherance of its monopoly. The district court entered an injunction (I have to believe that Intergraph had the home court advantage). Intel appealed to the Court of Appeals for the Federal Circuit which is the court that handles all appeals that arise out of patent cases, including antitrust issues arising out of patent cases. I think that's going to turn out to be significant as time goes on. In the meantime, the FTC investigates Intel and files a complaint that largely tracks the Intergraph complaint and says that Intel refused to provide information to a variety of customers except on the condition that they cross-license back to Intel all of their technology, and the intent was to coerce customers into giving all of their intellectual property to Intel, and this entrenched Intel as the dominant microprocessor seller.

Intel settled with the FTC, agreeing to an injunction that bars it from refusing to sell microprocessors and refusing to provide technical information to a customer for reasons related to an intellectual property dispute. In other words, if the customer sues Intel, it can't cut him off. However, if the customer is seeking an injunction, Intel can cut them off because the injunction could kill Intel's business. Thus, if all the customer wants is damages, Intel can't cut them off. If Intel's reason to refuse to deal has nothing to do with IP (like they are a deadbeat), it is allowed to stop dealing with them. Intel, interestingly, is allowed under the FTC Order to require that its technical information be used solely for systems that incorporate Intel microprocessors. It is not compelled to give away its intellectual property for people to use in competition with it. That was not part of the relief that

the FTC obtained. The FTC essentially said that people who develop competing technologies can negotiate better licenses with Intel, as they will have more bargaining leverage because Intel can't threaten to cut them off from the technical information that they need.

In the meanwhile, the CAFC is considening Intel's appeal of the injunction entered in Intergraph's favor. On the same day that Judge Jackson's findings of fact came out, the CAFC decision in Intel came out. It got virtually no play in the newspapers. Microsoft got all the play; Intel got a little squib. It is a very important decision, though. The court held there were no competitive effects in markets in which Intergraph competed, and therefore Intergraph did not have an antitrust claim. Intel is not an essential facility; the essential facility doctrine was limited to circumstances where competitors are excluding another competitor from the market, and it was not applicable to circumstances where an alleged essential facility was being sought by a customer. The court further held that it was not going to take what was essentially a contract and IP dispute and turn it into an antitrust claim for Intergraph. The Sherman Act doesn't take harsh commercial actions and convert them into antitrust violations, and unilateral conduct that adversely affects somebody else's business, i.e., Intergraph, may not be nice, but if there's no monopolization of that business, there's no violation of the Sherman Act. Plus the court says that Intel played hardball with all of its customers, and that was part of Intergraph's case, and it says it's not our job to readjust contracts, we are not going to do that, and the owner of proprietary information has no obligation to give it away.

There was an allegation in Intel that's similar to the allegation that Microsoft took its operating system monopoly and leveraged its way into a browser monopoly. The allegation was that Intel took its microprocessor monopoly and tried to leverage it into graphic subsystems, which is a different market. The CAFC here says *Berkey Photo,* which is perhaps the most often quoted case on "monopoly leverage" is not good law and we are not going to apply it. There's no indication that Intel achieved market power in these other markets into which it was allegedly attempting to leverage, and without an attempt to monopolize (and most circuits agree with this, by the way) without an attempt to monopolize the second market there's no such thing as a cause of action for "monopoly leveraging." And the mere fact that Intel decided to enter this downstream market is not illegal, even though it had a monopoly in microprocessors. If we drew the line too tightly, that would prevent people with monopolies, even if lawful monopolies, from trying to enter new markets.

Next, Intergraph said, "Well, we may not have proved leverage all the way and we may not have proved essential facility all the way and we may not have proved an attempt to monopolize all the way, but we put in elements of each of those, so give us a break." The CAFC says, "No." A quarter of a cause of action plus a third, plus a half doesn't equal one. That's essentially what they said. Intergraph tried to use *Continental Ore* and some other cases saying, "You have to look at totality of the conduct." The CAFC correctly said, "Show me some cause of action, show me something. Don't show me pieces of causes of action."

Now, the FTC's theory in its case was that it didn't have to show competitive harm. That was rejected by the CAFC. Of course, it had a private case in front of it; Intergraph is not the FTC.

There are implications for IP holders' ability to refuse to deal. Intel justifies refusing to deal, even if you're a monopolist, and even if your customers are demanding that you continue to supply them.

The question that I'll leave you with is whether the competitive harm issue addressed by the Court of Appeals for the Federal Circuit is at all relevant to the *Microsoft* case? Recall those findings that I put up on the board before about the lack of effect on Netscape; the fact that Netscape had millions of users, was expanding its use (although not its market share) and trying to line them up with what the CAFC did in *Intel*, and I think they are very hard to line up. If I were Microsoft, I'd be using this case in the D.C. Circuit.

Now, to be sure, I think the Court of Appeals for the Federal Circuit sees many knee-jerk antitrust counterclaims in patent infringement cases, and lots of them are really very weak and they are efforts to try to gain some bargaining leverage on the part of an infringer. The court has explicitly expressed its distaste for turning every patent infringement litigation into an antitrust case, and to some extent this may be part of that attitude, but this is a very influential circuit with some very good judges, and since antitrust issues more and more frequently arise in the context of a patent infringement case, this is the court that's going to be deciding those issues. This court is more likely to come full circle, to decide that intellectual property wins and antitrust loses where it has to balance them, because it really was not attempting to strike a balance in the Intergraph case; it just said antitrust loses.

JAY SIMON, ESQ.: Good afternoon, ladies and gentlemen. One thing I can promise you, except for my next breath, I am not mentioning the words Microsoft and Intel for the next 25 minutes. So if you care to hear about them, you can take a break now.

What I do want to talk about, however, is harmonizing antitrust and intellectual property laws from the point of view of the practitioner when he or she sits down to write a license agreement that will license intellectual property to somebody else but will not run afoul of the antitrust laws.

And, by the way, just as an aside, this conflict between the antitrust laws and the intellectual property laws is not a recent conflict; it is not recent to the United States nor is it recent to the IP guidelines or the Reagan administration or the Nine No-No's. When the British Statute of Monopolies was passed, which was some years ago, there was in it an exception for new inventions introduced into the realm, and of course, that was longhand to what a patent was. It had a little different meaning in those days than it does today, and I think that if you study the legislative history of the Sherman Act, you will find that Senator Sherman—who I think was related or may have been the brother of General Sherman, but that's neither here or there—was asked the question on the Senate floor what about patents, and the Senator was supposed to have responded, "Patents, of course, are an exception."

Now, it is uncontested that there are things you would want to try to do, that if you did not have a patent, would clearly violate the antitrust laws. But if you have a patent, then you can get away with a lot more than if you don't have a patent. So a lot of the issues that we talk about today get alleviated somewhat if you have patents. Nevertheless, a lot of patent holders love to use the leverage of having the patent to extract royalties from someone else in situations where those royalties may not otherwise be due. So I'm going to talk a little bit about patents in the context of tie-ins and how patents are sometimes used to get more royalty than you ought to get otherwise.

The first thing I want to talk about is a hybrid license. Many of you may have heard the term hybrid license. Those of you who are not patent practitioners probably have never heard the term and you will think of something about plants or something like that. It has nothing to do with plants. It has to do with license agreements in which patents and technical information, patents and unpatented technical information, are licensed by a licensor to a licensee in the same agreement; where one agreement says, "I grant you rights under certain of my patent rights and I grant you rights as well under certain of my confidential technical information." Now, the problem arises because patents and trade secret—if I can use that term broadly to define confidential technical information and I'm going to use it whether you like it or not—come from different legal bases. Patents, of course, come from the federal bases; they are expressly authorized by the United States Constitution, whereas trade secrets are the confidentiality of information or the ability of one party to impose an obligation on another party not to divulge the information that he or she is receiving. It is a creature of state law and of common law, a different system, far predating the United States Constitution.

The fundamental rule in patent law is that you may not charge royalty for a patent that is neither being used nor is expired. So if I have a patent and I license you under that patent, when that patent expires I cannot continue to collect royalties. That seems to be a fundamental proposition, but when people have patents they think can do wonderful things. They think, "Because my patent is so wonderful I'm going to charge you for more than 20 years from the filing date of the patent; I'm going to charge you for 25 years because I have the patent and you need access to the patent." Well, that is wrong. You cannot do it. It is a violation not only of the patent misuse laws, which I'm not going to get into today, but is also a violation of the antitrust laws. So you have one fundamental principle with patents at work; that is, you cannot charge royalty after the patent expires. Period. End of discussion. But, but, but—no buts. Can't do it. Okay.

Okay, let's take a look at trade secret law now. We have some Supreme Court decisions on this case, the most famous one is *Aronson v. Quickpoint Products*, and I have a lot of useless trivia. Mrs. Aronson, who is the Aronson in that case, was the wife of Mr. Aronson, that's pretty obvious, but Mr. Aronson was the guy who founded the Ronson Lighter Corporation. He just dropped the "A" and called it Ronson. [Anyway, one thing I didn't mention when I stood up here is that Barry gave me a very nice introduction, but he did not say that I was the oldest person on the panel. That will get me nothing from this panel nor do I expect it will get me anything from you.]

However, going back to Mrs. Aronson. What Mrs. Aronson did is, she licensed a patent application to the Quickpoint Pencil Company. In those days and even today in the United States, patent applications are maintained in secret. Nobody knows what's in there except for the person applying for the patent and the United States Patent Trademark Office. So it is, in essence, confidential information. When she applied for the patent the deal she made with the Quickpoint Pencil Company was, "Look, if I get a patent, you'll pay me five percent royalties on all of these things that you sell. If I don't get a patent, you'll pay me two and a half percent royalties." Period. End of agreement. That's it. Short, simple, very sweet. No problem at all. And by the way, the thing that was being licensed was a little pull-apart key chain. Every time I give this lecture I vow to bring a key chain with me, and I always leave it home. It is a little advertisement given out; if you go to a convention somebody will have a little piece of advertisement on a button and a little C clamp that puts it over a button you can pull apart and hold a key on. That was the whole deal. Once you see this thing it is very clear that there isn't a hell of a lot of confidential information. Nevertheless it was confidential at the time, and she could do this kind of a thing.

So time goes by. Can't get a patent. Quickpoint starts paying two and a half percent. More time goes by, in

fact, so much time goes by that the patent would have expired had a patent been granted, and Quickpoint wakes up and says, "What am I doing here? I'm still paying this lady. She's a nice old lady, she's probably from New York or Connecticut, a wonderful lady, but I'm still paying her 2½% royalties. All my competitors are out there for the last 17 years—used to be 17 years from the date of issue was the patent term—all of my competitors are out there selling this thing, and they don't have to pay anybody any royalty because there's obviously no confidential information here." They go to court. "I don't want to pay you any more royalties, Mrs. Aronson." Mrs. Aronson says, "No, you've got to continue paying. That's what the agreement says." Fundamentally, Quickpoint's position was, had a patent issued they could have stopped paying royalties because we all know, as I've told you a moment ago, you cannot charge royalties once a patent expires. We know that already. So that's Quickpoint's case. "Had a patent issued, Your Honor, no more royalties would be charged." Mrs. Aronson says, "Look, I understand all that, but there was no patent. As a consequence, we can't look to federal law here because trade secrets, which are confidential information, which is the information that I gave you, Mr. Quickpoint Pencil Company, was confidential at the time. The fact that it fell into the public domain immediately upon manufacturing and use of this first key chain has nothing to do with that."

By the way, many of you will write nondisclosure agreements in your time—or maybe none of you will do it. Anyway those are the NDAs that Alan discussed, and they didn't discuss it with Intergraph. I give you information; you agree to keep it secret. I'm from a big licensor. We don't license anybody else's technology. We think we know it all. But we license out our own, and when we license out our own technology we say you'll keep it in secret forever. "Oh, no, no, we are not forever," that's the response. Five, ten, fifteen, twenty years, whatever. But time does not change confidential information into nonconfidential information. Simple as that. You've got record-keeping problems, that's your problem. However, I must admit to you that when I'm on the other side, which is rarely, I use all those arguments. It's whatever you can get away with, basically.

So the Supreme Court said in this case, "Look, Quickpoint, when you got this information it was confidential. You made a bargain. The bargain was patent issues 5%, no patent issues 2½%. No patent issued, 2½%. End of discussion, that was your bargain." It is governed by common law. It is governed by state-operated trade secret law, not by the federal patent law. So now you have the two sides of the coin here. You can charge forever for trade secret information. Generally you'll have in your nondisclosure agreements that the information will no longer be confidential, for example, if it falls into the public domain through no fault of the recipient or something like that, or a time limit. However, if you don't have a time limit, you can continue to charge forever, and even if there is a time limit, what the Supreme Court said was that, "You, Quickpoint Pencil Company, the recipient of the information, are getting the benefit of the bargain. You were able to get into the market today before any of your competitors could get into the market, and you have a leg up because you have something that nobody else has, and that's enough consideration for the bargain, yes, to continue to pay forever." The last I heard, they are still paying. Either that or a they made some kind of generous settlement with the heirs.

A similar case, just to show you this is not an oddball. A similar case involves Listerine. Listerine was not invented by Joseph Listerine. He invented something else. Listerine was just some name some guy came up with. This fellow invented an awful tasting mouthwash. It was terrific, and he gave the rights to the predecessor of the Warner Lambert Pharmaceutical Company. In the agreement back in the 1890s or something, in the agreement it says, "Look, you'll pay to me, my heirs and successors and their assigns so many dollars for every gross of this stuff that you sell." That agreement is still in effect. Even though the Food, Drug, and Cosmetic Act that came out in 1985 made you have to put all the ingredients on the label of the medicine bottle or mouthwash bottle, and even later on it was very clear what the ingredients of the mouthwash were, but that was the deal. They got information in confidence at the time; you have to pay forever. You have to pay for as long as your contract states that you shall pay. Of course, you could always write into the contract, "I'm not going to pay any more than X number of years," or "I'm not going to pay when the information falls into the public domain," or "I'm not going to pay you after I pay you a hundred million dollars or ten thousand dollars or whatever the fundamental issue is." Whatever the parties agree upon, that's what's going to govern the relationship between the parties. So add that to my hybrid licensing.

So you've got two fundamentally different legal systems governing trade secrets and governing patents in a hybrid license agreement. So here we are, I'm licensing something, my company, we are big, into refining processing. It will cost you probably half a billion dollars to put up one of the units that we are licensing, and we are going to give you a license to operate the unit for however long you want to operate the unit. We have certain patents and a lot of technical information that's confidential to us. The patents expire. We all know that patents expire at some point in time because that's the law. Well, okay the patents all expire. In this agreement, I've said I've licensed you rights under my patents, and technical information; you're going to give me a dollar for every barrel you produce. My patents expire. Weren't my patents part of the consideration that you received for giving me the dollar royalty? Of course they were.

There was patent rights and there was confidential information. That was the consideration for which I get the dollar back. But the patent rights no longer exist. Actually happened in a few cases. Went to court, the court was very clear, you continue to charge the dollar; the court says that you can continue to receive the dollar. It is clear that you are getting money for patents beyond their expiration date because it didn't make up the total amount of consideration; it only made up a part of the consideration. But the court was loath to take on the ability or to take on the issue of allocating the amount of royalty between patents and technical information. If you look in my outline, you'll see a bunch of old cases on this, we were all younger, had darker hair and maybe some more hair.

What's amazing to me is that in my position I see agreements of lots of other parties and lots of other companies that do licensing, and just two weeks ago I came across an agreement from a company that's, I don't know, one of the eight or ten largest companies in the world, and they are still making the same mistake that the courts had settled some time ago.

In any event, if you license the technical information and the patent rights for the dollar royalty, the patents expire, what do you get? You get a lawsuit, that's what you get, because the court will not determine the amount for the technical information or the amount for the patents. So what you're doing is buying a lawsuit or you're buying another negotiation. So what to do?

Putting in your agreement that, for example, as this company did, that you, Mr. or Mrs. Licensee, recognize the real value of these patents and irrespective of the fact that they may expire during the term of this agreement, you'll continue to pay me the same dollars. That's baloney. That doesn't work. And it's not going to work, and anybody who thinks that it is going to work ought to get out of this business. I shouldn't say that. That's not right because otherwise these guys would have nothing to do.

So what do you do? Well, you allocate. You allocate a percentage of the royalties to patents and a percentage of the royalties to the confidential technical information. How much do I put on each? I don't give a damn. Court doesn't care. You can put 99 percent on one, one percent on the other, vice versa. The courts really care less because now you're just making up what the bargain is for the license agreement. Okay, what it does is that it forces a licensor, and the licensee as well, to look and determine what is the value of the patent, what is the value of the technical information? If you're the licensor and you see that your patent that's being licensed is not a very strong patent, you know there is some prior thing that you cited to the patent office so you won't run afoul of the inequitable conduct laws (which will be next year's lecture), but you know that it is not a really strong patent, somebody could make a good argument to invalidate a patent, so maybe you don't put too much money on the patent; put it all on the technical information. And if you're the licensee you have that consideration as well. But if the confidential information is strong and nobody is going to find it out because they are not going to operate this particular kind of unit, so you put a lot of money on the confidential information, that's okay. When the patent expires you're still getting the bulk of your money. However, if the patents are long and strong, by that I mean you really feel that the patents are strong and have a number of years to go, whereas the technical information is somewhat problematic, you may put a lot of money on the patents—on the patents rather than on technical information. Your choice. Choice between a discussion between the licensor and the licensee and the negotiation for the licensing agreement.

There is one way that you can still charge the same dollar and not allocate. And that is you get all your money up front. Now, nobody is going to pay us the $20 million on the day we sign the agreement, but they might pay us $10 million today, $10 million a year from now, because we all know how long the patent takes, and by expiration of the patent I don't mean merely that the term ends; I mean it is found invalid so that it expires early. But a patent suit takes more than a couple of years, and until the judgment is final, you can continue to collect your royalty. And even if it is found out that the patent was invalid so that it should not have been granted, you can keep the royalty. The licensor can keep the money because the licensee has been operating under the imprimatur of a valid patent because the United States Trade Office issued it. So everybody thinks it is valid until it is proved not valid. So you can keep the money.

So there are really two ways to avoid the problem. Well, three. Write two separate agreements; one for patent and technical information, one for allocation between patents and technical information, or get all your money up front, or pretty close to getting it all up front.

Now, you all understand hybrid licenses, so that will never be a problem again, and you'll never have to worry about telling your vice-president or president, that, "Gee, we can't justify what we did here 20 years ago, but you can blame it on somebody who is retired."

But I want to talk a little bit about discriminatory royalty rights because they are really a fun issue. Discriminatory royalty rights have been an antitrust issue but they have also been a misuse issue, and fundamentally what they involve is I charge a buck, I charge 90 cents or I charge $1.20 for licensing the exact same quantum of stuff, whether licensing and trade patents and trade secrets or one or the other. I'm discriminating among my licensees as to how much I get from each one.

There's a really fascinating case on this. The case has to do with shrimp. Big shrimp. You know it is a great oxymoron. A company came up with a method for deveining shrimp. Instead of you sitting there all the while and pulling that thing out, it really gets messy and you need several different napkins in order to do it, so there's a shrimp deveining machine. This company licensed the use of the machine to the shrimpers all over the United States. It turns out that Gulf Coast shrimp are big shrimp, northwest coast shrimp are little shrimp, okay. The royalty rate was paid according to the number of shrimp deveined. You have little shrimp, but how are shrimp sold when you go to the market? You know how it is sold, they are sold by the pound. Now you'll ask at the market how many shrimp in a pound, and they will tell you 32 to 34, but it is still sold by the pound. So if you have little shrimp, more shrimp to the pound; big shrimp, less shrimp to the pound. In fact, what happened was several northwest coast shrimpers went out of business because they were paying so much royalty, the royalty being based on the number of shrimp peeled as opposed to the number of shrimp in a pound. Action was brought, an antitrust violation. The company was in litigation—and there're dozens of litigations on this thing; it is called the shrimp peelers cases. Those of you familiar with patent law will have heard about them. They are fascinating stories. What's really interesting about it is that the patentee later on changed the royalty rate; "I'm getting creamed here because I'm charging on the basis of how many shrimp are being peeled." So later on they changed the royalty rate to say, "Okay, we'll charge on the basis of pounds of shrimp peeled." Northwest coast shrimpers were peeling shrimp left and right, because they could a peel all these shrimp and because there was more shrimp in a pound, and the Gulf Coast shrimpers thought they were at a disadvantage so they brought an antitrust suit against the patenter. That case was thrown out. I didn't really read the case. I just think it is an interesting piece of information. There's nothing that this company could do right.

So where are we on discriminatory royalty rights? Well, the fact of the matter is that if you look at 35 U.S.C. § 271(d), which covers patent infringement and you look at what's no longer misuse and you look at case law, the fact of the matter is you can charge different royalty rates to your different licensees. Even if the licensees are in competition with each other. Wait a minute now, I've said something here that doesn't sound right. A and B are competing with each other but I can charge each one of them different royalty rates. Doesn't that put one at a disadvantage to the other? On the surface it does. It certainly does, one vis-a-vis the other on royalty rates it is. But royalty rates are only a small issue when it comes to determining one party's profitability or one party's cost structure. And there is a famous case on that that was also written by the same judge who is now the mediator—I said I wouldn't mention it, right, by Judge Posner, in "that" case. So it was a nicely reasoned opinion when he was sitting on the Seventh Circuit. Basically you can charge different royalty rates. However, if—and you know by the discovery rules that you all get involved with in this country—if your plan is to literally favor one licensee over the other licensee, you're going to have a lot of trouble, because then there's a particular antitrust issue that you were trying to drive one person out of the market. You know, we have all this market power definition, defining the market, market power, showing misuse of the market. But the shorthand rule is purpose and effect. What was the purpose of what you did? What was the effect of what you did? If the effect of what you did was to drive somebody out of the market and your purpose was to do that by charging different royalty rates to competing licensees, you're going to have trouble, and that could well be a misuse and could well be an antitrust violation.

I'm just going to tell you one more thing. And the bigger issue here is package licensing, not so much exorbitant royalty rates. Exorbitant royalty rates is a very high royalty rate. That's all it is. How much can you charge? You can charge as much as the market will bear. You can charge as much as you can get. There's one oddball case out in the midwest or in the Rocky Mountain states, and maybe they were out too late in the cold weather or whatever. And that said, well, this royalty rate was too high. Too high as opposed to what? But for my patent and my license you would not be in this business at all. The case was remanded on other grounds; it is an oddball case. You should just be aware that it exists. But you get as much as you can. That's the basic rule in charging rates.

The other issue I want to cover is package license. What's a package license? A package license is you've got a bunch of patents, and I'm going to license all of the patents because you, the licensee, need a bunch of the patents in order to manufacture or produce whatever products you want to manufacture. Well, how do I charge for this? I could say, "Well, if you take one it is $10.00, if you take two it is $12.00, but if you take all three it is $8.00." Bargain specials, you see that in the supermarket all the time. Buy a few more, you get it for a lower price. Well, in one case, at least, the Supreme Court of the United States said that was coercion—even though there was no other overt evidence of coercion—in order to take a license for more patents than the licensee actually needed. I don't know if that's such great law, but what you have to remember is that if you have a bunch of patents that you're licensing as a package, how do you want to fix the royalty rate? There are a lot of different ways you can do it. Any patent you want is 1%. For example, you want another patent, that's 1%; you want another patent that's 1%, up to a maximum of 8% then you get them all. That's okay. Or my basic patent is

10% and everything after that is 1%; we just add them up. That's okay too. Hark back to what I said earlier about how you can't charge royalties once a patent expires. In a bunch of patents, obviously, the patents are going to have different expiration dates, so they are going to expire as time goes on.

There is case law—a company that we just bought because we needed that case law. So case law that says as long as you have one patent that's in effect and being used you can still charge the same royalty. That's a little strange, even though the patents have expired. And I think the basis for that is that you can get anything you want for the patents and you could have picked whatever number you wanted for any one of the patents. So as long as there's one still in existence being used, you don't have to reduce the royalty.

What is my advice to you? My advice to you is as the patents expire, reduce the royalty. You'll have less trouble, less conflict with your licensing. You'll show you're being a nice guy. And if you're the licensee, you should ask for something like that: let's reduce the royalties as the patents expire.

DR. ROBERT E. HALL: I should say at the outset that I do work for clients in other matters. I have enjoyed the role that I've held since 1995 of not working for any party in *Microsoft*. You might ask, how can I afford that luxury? The answer is, my employer encourages that. The Hoover Institution, who pays my base load salary, likes people to work on national policy issues, and I selected this as the national policy issue that attracted me most, having worked on other issues such as taxation and monetary policy prior to that.

I'm going to start with just a few comments that I can't resist about the procedure that the government adopted in the *Microsoft* investigation and trial, which I thought at the time and I continue to believe is not the right way to do it. The government's strategy—one that is not an alien strategy to lawyers—was to determine which of a wide variety of types of antitrust misconduct could be proven and then, based on the findings of the court structure, impose a remedy that would provide appropriate relief from this misconduct. In other words, verdict first, sentence later. Seems very logical. Despite the logic of this procedure, I argue that the "Alice in Wonderland" approach, which was the opposite—sentence first, verdict later—actually makes more sense in this context. Let me explain.

I think that the government should have gathered the evidence itself in the investigation phase of its procedure in the fall of 1998, and then thought very hard as to what remedies would have prevented the misconduct or corrected its effects, and then presented a case in court which focused on showing that the consumer would be better off under the remedy. In particular, the analysis should have focused attention on something that many commentators have pointed out was lacking in the government's case: a focus on harm to the consumer. There was no but-for analysis presented in the government's case, which would have said, "But for the misconduct, here's how things would have evolved differently in the operating system market, and here's how Windows would have been cheaper and better and the consumer would have been better off if there had been a remedy in play at that point." This would have been the more compelling way to organize the case. As it stands, I think the government is in a rather awkward position. It got way more than it expected in terms of findings of the court, at least to date, and now faces a real challenge to craft a remedy that makes sense and can deal with a rather large amount of misconduct that seems to have been proven. Now, I think—and I'll come back to this later in my remarks—that a serious case can be made that the government at this point should turn most of the case over to private antitrust proceedings. In particular, Steve Susman's success in the *Caldera* case, which settled recently for almost $300 million, as Mr. Lifland discussed earlier this afternoon, suggests that a concern about serious damages will be a significant disciplining factor for Microsoft in the future. This is the first time Microsoft has lost serious money in connection with its competition conduct, and it is real money. Of course, it is nothing compared to their market cap, but nonetheless it is real money, and I think it is taken seriously in Redmond, and a lot more can come. Certainly there are now something like 50 class-action cases, following up Judge Jackson's findings of fact, that have a potential for imposing even more discipline on Microsoft.

What has the government shown in the case and what is in the findings of fact? Collectively, what we now know is that Microsoft raised barriers to entry in Microsoft's core business, which is the desktop operating system, Windows. I have been doing research—abstract economic theory type research—motivated by this type of a setup where you have an upstream monopoly controlling a necessary input for a downstream industry. In this case, upstream Microsoft is controlling Windows for the downstream personal computer industry. In connection with that analysis, the findings of fact, and the other things I know about Microsoft, I've come to three important conclusions with respect to Microsoft. First, which I think is reasonably obvious, is that Microsoft has close to a monopoly in the desktop operating market. It doesn't matter how exactly you define that market; whichever way you define it, you reach that conclusion rather easily. Second, the price that Microsoft can charge for Windows is substantially constrained by the possibility of entry. This was quite well proven in the trial. Richard Schmalensee, Microsoft's economist, observed that the monopoly price of Windows is somewhere in the range of $1,000-2,000 a unit. In fact, Microsoft charges $65 a unit. There's a big gap between the actual price and the

monopoly price. So it is one thing to say that Microsoft has a monopoly, in the sense that they sell almost all units in the market, but it is quite another to suggest that they are charging the monopoly price. They are not. And although that was somewhat disputed by the economist for the government, who said no, it's not $1,500, it is $500, nobody said it was $65. Nobody said that Microsoft was able to achieve the monopoly price. There is a constraint at work, and the analysis of that constraint is central to understanding what the alternatives are, what the but-for analysis would look like when you come, for example, to do damages.

One of the things I do frequently in the litigation area is antitrust damages, and so I've brought my damages perspective to this analysis in a way that the government—at least the Justice Department—does not, because the Justice Department does not seek damages. It leaves that to either the states or private litigation.

If Microsoft has created artificial barriers to entry, which is what Judge Jackson has found, then this analysis shows that Microsoft has elevated the price of Windows, that is, it would have been less than $65 if the barriers to entry were not as high. The artificial elevation of barriers to entry then can be mapped to increase in the price of Windows. Here's where my analysis suggests that the price of Windows, $65, suggests it would cost about $9 billion for someone else to reproduce the Windows business and compete with Microsoft. That's about $½ billion of coding costs and $8½ billion of costs of overcoming all the other barriers to entry in this business, including the artificial barriers to entering. Suppose—and this is just a theoretical question—that Microsoft's conduct added $2 billion to the artificial barriers to entry. In other words, the natural barriers are $7 billion, and there's $2 billion on top of that that should not have been there. The but-for analysis lowers the barrier-to-entry amount to $7 billion instead of $9 billion. Then the analysis shows, and this is where an economist can really do something because we can actually manage these numbers, that Windows would have been about $10 cheaper. If that's basically what's been shown, then multiply that by the number of units, which is somewhere around 700 million, then damages from the misconduct are about $7 billion. That's actually quite a small number, since Microsoft is worth well over $500 billion. I think it is quite an important number to calibrate what we think should be done about Microsoft.

Another important implication of this analysis is that Microsoft would have been a near monopolist even under legitimate conduct. Microsoft got there first, and the analysis shows that whoever gets there first is able to prevent the entry of rivals. But I emphasize it is low pricing. It is competition at work. In fact, the consumer can enjoy the best of both worlds if the illegitimate conduct does not take place. The consumer still benefits from competitive pricing and uniformity. A single operating system that everyone uses that's completely compatible across systems is held to be a benefit by many computer users and commentators on the operating system business. My colleague, Tim Bresnahan, is hard at work in the Justice Department thinking through these topics. He's a very careful thinker and I look forward to his analysis.

If damages are around $7 billion—again, that's just an illustrative number to give a sense of what the order of magnitude is—then a remedy that lowers Microsoft's market cap by more than that amount could be excessive. It might even be in contravention of the Fifth Amendment. In other words, doing a serious but-for analysis and finding out that what's at stake here is $7 billion and not $100 billion is very central. Just to compare that number, Microsoft lost $18 billion in market cap on the announcement of rumors that the government was going to seek some form of breakup remedy. That number is two and a half times higher than my illustrative damages number. So there's a calibration issue here that we need to pay attention to.

My second conclusion is that there is no case for splitting up Microsoft if, but for the misconduct, the consumer would have had the benefits of a unified Microsoft without paying a high price. In other words, if we could have had this unified software business and yet a competitive price, that's the best of all worlds. If that's what the but-for analysis shows, then a remedy that breaks up Microsoft is not pushing Microsoft to where it would have been but for the misconduct, which is the desirable form for remedy to take. The remedy would not be simply correcting the effects of the misconduct; it would not place Microsoft where it would have been had it behaved legitimately, but it is going beyond that in ways that are potentially harmful to the consumer.

Third, and finally in this respect, since this session is about intellectual property, a split-up that allowed multiple players, either through licensing or through the Baby Bill proposal or anything that would introduce competition where Microsoft thought it would enjoy a lawful monopoly, such a split-up is far more than the effect of the misconduct. Then there has been not just a taking in general but an erosion of intellectual property values and incentives for the future, for any companies that might find themselves in the same position as Microsoft, companies who got there first, built something very desirable, promulgated it to hundreds of millions of users and then found that they lost more than the amount that they should have lost based on the amount of harm that they've done.

The government has proven that Microsoft created artificial barriers to entry, and in effect the nature of that proof focuses very much on the fact that Microsoft acted to prevent Java in the browser market from becoming an

effective rival to Windows. Judge Jackson's findings of fact are crystal clear that the antitrust harm comes from blocking entry to Windows itself and not in the browser market. The findings of fact are perfectly clear and a good piece of economics, and it corrects what I saw as some of the problems in the economics of the government's case. It is a remarkable document, and it focuses very much on this point that the wrongdoing was elevating barriers to entry in the operating system market.

Let us turn now to remedies, and here I'll be commenting on some of the other things that were said earlier today. The idea of a remedy of structural separation, which is separating the operation system business from the applications business, is one that was widely under discussion in the earlier investigation of Microsoft in 1994 in which I was a consultant for the Justice Department. We looked very carefully at that and could not find that such a remedy was supported by any of the facts that we knew at that time. And I reach the same conclusion today. The basic idea of the separation, however, is not bad. It means that if the applications company were separate from the operating system company, then the applications company wouldn't have an incentive to do things with respect to applications, like the browser, whose benefits are to raise barriers to entry to the operating system. So that kind of leveraging would not be able to occur under such a remedy.

Recall that structural separation was a huge success in telecommunications, in the telephone industry. It gave us a vigorous long distance industry today which would not have occurred without that principle. So it's a good principle, and at first sight there's a logic to applying it to Microsoft. But when you look at what it would actually mean, you lose enthusiasm as I lost enthusiasm when I looked at it in 1994. I saw that structural separation would require the court to determine what software is part of the operating system. An operating system is nothing more than a big collection of utilities. It is not a well-defined thing; it is just a package. So if you say there's a whole problem of packaging or bundling, of course, that's what an operating system is. It is nothing more than a package. There's a utility in Windows that I love, for example, that knows how to dial credit card phone calls. That could have been a separate product. It could have been an application. But it is very useful to me that I got it automatically from my version of Windows. That's what an operating system is. But in structural separation, the court would have to deal with impossible questions of whether something is logically part of the operating system or not. For example, is the browser a separate product or is it part of the operating system? To economists that's like asking, is the Gulf of Mexico part of the Atlantic Ocean? It is not a meaningful question to me. These questions (are they separate or the same?) shouldn't be asked. There's something wrong. We should be asking, does a particular remedy make the consumer better off? That's a coherent question. It is not a coherent question to ask whether the browser is part of the operating system or not, unless you could somehow link that question to consumer welfare, which I don't think you can.

Equally, the application branch of the company, or a separate company spun off, might start selling software that looks suspiciously like an operating system. That too would be brought to court. It's very important to understand that there's a lot of rent-seeking in antitrust litigation. A tremendous number of antitrust cases, especially those that connected with, say, enforcing a consent decree, go through the Justice Department. The court that's in charge of the consent decree has to deal with rent-seeking, meaning that every time Microsoft wants to include something in the operating system there is another party whose interests are contrary, who will oppose that. So the court will have to sit continuously listening to software developers explain why Microsoft should not be allowed to put into the operating system something that competes with their separate package. The whole history of Windows is nothing but the conglomeration of something that was sold separately before. I think we wouldn't have Windows today if we had not allowed it to grow by accretion. So it is said that conduct remedies are hard for the court to enforce because you have to look at the conduct all the time and decide whether it's okay, but that structural separation is magic, surgical. It is just not true. Even the long distance structural separation, which was a very good idea, had a huge amount of rent-seeking and a lot of litigation over just where the boundaries were in a way that became very dissipated.

The other proposal is horizontal divestiture, the "Baby Bills," which is a complete misnomer since the Baby Bells didn't compete with each other, whereas the Baby Bills in Microsoft's case would be horizontal competitors. Again there's a logic to this. If the problem is that there isn't enough competition, that virtual competition should have occurred, should have disciplined the price of Windows, then we'll introduce real competition to take its place. But the problem is that the government, to avoid a significant Fifth Amendment issue here, would have to show that the lowering of price that would come from having the Baby Bills compete with each other would lower the price only to the point where it would have been but for the misconduct. And as economists think, that would be very difficult. My prediction would be that price would have to be lowered practically to zero under almost any scheme that gives rise to very substantial competition. This is a product that has a marginal cost of zero. So its competitive price is zero. If you introduce a lot of competition, you're going to get zero. It is undesirable. It is not sustainable in the long run if the operating price commands a price of zero. The right price is something at $40 or $45. We need a remedy

that doesn't push the price down to zero but gets it down to where it should have been. So I don't see where those remedies make a lot of sense.

On the other hand, the conduct remedies have been disparaged. As somebody who had contributed to the 1995 consent decree I can claim a little bit of ownership interest in these ideas. But I think there's more to be done on the conduct side. In particular, Microsoft didn't get the point of the '95 consent decree, and we need to go back and tell them what the point was and do it over again.

In the meantime, remember that the *Caldera* case, which cost Microsoft almost $300 million, dealt with those consent decree issues, so I think they may be getting it now. And the other idea which I think is quite a good one goes under the general idea of the clean Windows license. That is, a Windows license which is a separate transaction which cannot be used to lever the behavior of computer makers and others who license software from Microsoft. I think that's wise—but I don't promise big effects from this any more than I ever thought there would be a big effect from the '95 consent decree. So my recommendations and summary are the following: First, don't go for the big structural remedies; they don't make sense in an intellectual property-based industry. Second, leave the bulk of providing the right incentives under antitrust law to the capable hands of Steve Susman and Arthur Kaplan and the other very capable lawyers who are undertaking this task as I speak. Third, enhance the consent decree to bar conduct of the type that the findings of fact showed actually occurred. Such conduct can be surgically and effectively barred with a new consent decree.

MR. BRETT: We have a few minutes left before we have to break. I have some things that I would like to pose, but are there some questions from the audience first?

SPEAKER IN AUDIENCE: I have a question for Steve. I'd kind of like to take some of what Dr. Hall just said and move back to the legal issues. You talked over the course of this afternoon, there's been talk about what the Supreme Court standard was in terms of undoing the harm of a monopoly under § 2. I think that most people would agree, and I think that the court's findings support the notion that Microsoft got its monopoly and operating systems legally, superior foresight in the industry, the stuff we read about in *Alcoa*, and it's the way that it maintained that monopoly that went over the line. So the question is: if it was initially a legal monopoly, these attempts to, as Dr. Hall said, raise barriers to entry and maintain its monopoly or where it went wrong, how do we bring that all back to what the Supreme Court said you can do in remedying a monopoly once it's been found? And it seems to me, that maybe it does set some pretty—not clear limits—but limits that would constrain the relief the government could get.

MR. HOUCK: One of the real problems is the amount of market power that Microsoft has. And the problem in dealing with that in a conduct-based consent decree is that as long as the power remains there, the incentive remains to maintain the power, and it's clear from Microsoft's past conduct that it is very clever, and you know, very insightful. A lot of this comes from Mr. Gates, who is an extraordinary businessman, in anticipating how to use that power to prevent other companies from competing on a fair basis with Microsoft. So it's just—I think structurally I'm not saying it is impossible to do this with a conduct-based remedy; it is very, very difficult to be more imaginative than Microsoft is in trying to anticipate how it is that the company might use its extraordinary power, as it has done in the past in a variety of ways to inhibit the future competitors. And in large part that's what happened with the consent decree. It was fairly narrow in language, and it really was not even a road block in the road that Microsoft took. So I think that is a significant problem in endeavoring to fashion any workable conduct-based consent decree that cabins in Microsoft's power and prevents it in the future to thwart competition.

MR. BRETT: Sir.

SPEAKER IN AUDIENCE: Among the structural remedies that have been discussed, just breaking it into Baby Bills or by functionality, no one has mentioned the idea of the less dramatic remedy: go for forced licensing which would kind of have the same or similar effect as a Baby Bill but without the dramatic effect on *Microsoft* itself. Is that being pursued?

MR. HOUCK: Without giving away any state secrets, you know—that is because it has been in the papers—but certainly that has been something that has been looked at. Now for the reasons you state, I think, theoretically it has an awful lot of appeal. You know, it is less drastic than breaking up the company, and it does seem to go to the heart of the market power that's been the problem throughout. The real difficulty, I think, is a practical one of making sure that any package of intellectual property rights that's licensed is something that would appeal to a company that has the potential to be a substantial competitor. I think one of the real world problems is that a lot of companies may be so intimidated by Microsoft and its reputation and its knowledge that a potential bidder might fear if it had those rights it would be perceived by the public as offering a second-rate package and not the real thing, something else. And without the necessary amount of knowledge by the programmers and whatnot, it might be difficult to keep up with Microsoft. But I think that's certainly something that is worth considering, and I think that may be something that would be doable with Microsoft's cooperation,

if they were so interested, you could probably work with them to make sure that the package might be doable and appealable to—you have to have some appeal—to other companies.

MR. BRETT: I just want to ask Bob and Steve to address the whole concept of equitable relief in this industry. I found it interesting that the same day that the story broke about the government seeking structural relief, the AOL-Time Warner story broke, and the story broke again the same day about IBM outfitting its systems to use Linux. This industry is changing so, so rapidly; we have no idea what it is going to look like six months or a year from now. And Alan alluded to some of the rapid changes, whether we are going to broad band and what is going to happen. If relief is entered six, eight months from now by Judge Jackson, assuming it does go to the Court of Appeals rather than direct appeal, we are going to be three, four, five years from that relief becoming effective, and how does one divine now relief based on conduct that's already several years old to be effective in an industry that's going to change dramatically and won't go into effect in five years and to figure out how to do that? How can you possibly try to work that out and make sense?

MR. WEINSCHEL: Let me add a footnote. There was an article in the paper—I think it was last week—about this little company that had come up with an Intel competitor chip that they had been developing in secret for five years which nobody knew about. That tells you that the predictability of these marketplaces is a really tough, tough issue.

MR. HOUCK: You guys didn't pay attention to what I said in my remarks. You can't look at the software industry in totality. This is a case about the operating system market. AOL has zero—zero—to do with operating systems. They don't make operating systems; they don't sell operating systems. The AOL-Time Warner merger has nothing at all to do with the *Microsoft* case. Linux was the subject of a fair amount of testimony in the *Microsoft* case, and I think you will see in the judge's findings that he at least—and there is substantial evidence to support this—considered it a niche operating system. It is impossible to predict what might happen in the future, but at the present it does not pose a significant competitive threat to Microsoft, and the purpose of the remedy is to restore the marketplace *ex ante*. And you can't depend upon some speculative new product overtaking Microsoft, because there have been other major efforts made by very major competitors like IBM that have not made a dent in Microsoft's monopoly in the last ten years.

MR. HALL: Well, first, I agree strongly with Steve's remark that the operating system is different. It is the web that's changing rapidly. The desktop is a relatively slow-moving, tremendous cash cow, and it's not a super vibrant industry, except to the extent that the desktop supports some web activities. But I think Steve is exactly right on that point.

On the other hand, the issue of change is one that needs to be thought of. I would come back to something I said before, which is that in the law that I'm used to, the law favors a monetary remedy for past misconduct. When did we throw that rule away? Microsoft, if it thought that every time in the future when it does something that's anticompetitive is going to have to pay damages for it, will learn its lesson well. The best way to teach them that is to charge them dollars for what they did in 1996. The question for Steve is: do the states have the power to seek damages? Are they going to exercise that power? Or is Arthur Kaplan in charge of that?

MR. HOUCK: Well, I obviously am no longer with the state, but I don't think damages are the total answer, certainly. They will be part of the answer; they are one of the panoply of remedies available. You know, the state attorneys general and the DOJ are entitled to seek equitable relief which is the traditional remedy for violations like this, in addition to damages relief. Some states no doubt will bring their own damage claims, but could have an *Illinois Brick* problem that might make it more difficult for them. But I wouldn't be surprised to see some state attorneys general lined up with damages actions similar to the class actions that have been filed.

MR. BRETT: Quickly, I just want to observe that we are going to have Bob back next year, and we are going to explore his observation that the telecommunication decrees were wildly successful.

MR. HALL: With pleasure.

MR. BRETT: But getting back to a more pragmatic issue, I would like to ask Jay and Alan to comment on something that affects our everyday life, and that is the question of whether or not the manner in which information is being communicated to the practitioners by the government is very effective. Can you gain enough guidance to divine how you practice and how you counsel from things like guidelines, Intel consent decrees, and circumstances where we are not getting a lot of actual litigation and court decisions in the area but have to look to unusual places to find guidance to the government's point of view and can't figure out what the law is?

Jay, where do you go to figure it out?

MR. SIMON: Let me just say that sometimes the government doesn't give good advice. Sometimes I think they've got it pretty much right with the last set of IP guidelines, but I'm not sure they got it right with the Nine No-No's which threw my industry into an uproar for a long period of time. But on the other hand, nobody else is trying to do this. Nobody else is trying to make any sense of what the laws are in licensing, and so the guidelines become very, very important to us. So, one of

the problems that I have with the guidelines, as Alan pointed out, is about the innovation markets which is something that the other gentlemen on the panel are looking to. What's going to happen in the future if you put two companies together; will they find a drug for cancer faster than if you have three or four looking for it? And I don't know the answer to that. I don't know that anybody else knows the answer to that, and I wonder why the government is stepping in and making guidelines in those areas. But maybe in one sense it is a tip-off to the practitioner of what the government is going to be looking at, and in that context it is very important for the individual practitioner, because then he or she knows what the government is going to look more closely at and with greater scrutiny as opposed to other areas that might have less scrutiny attached to it.

MR. WEINSCHEL: I agree with Jay. I want to relate a conversation I had with Rich Gilbert who was one of the authors of the *Intellectual Property Guidelines* right after they came out. He and I went at it with some vigor on "innovation" markets. His response, I think, was a good one: "Watch what we (the DOJ) do as much as what we say in the guidelines. Don't think that we're going to be silly about where we use innovation markets." I think we can quibble about some of the cases that they brought, and I think that a good number of them I personally would not have brought, but at least there's room for debate. I don't think that they've taken that concept and extended it outrageously. And again, there is a second piece in terms of guidance from the guidelines: You're going to have to buy my book.

MR. BRETT: I think Meg is telling us we have to quit.

MS. GIFFORD: Yes, I am. Sorry.

MS. GIFFORD: First of all, I want to take just a few seconds and thank the moderator of the previous panel who didn't introduce himself, and he didn't give me time to introduce him. So I want to formally thank and recognize Barry Brett who is a member of the Parker, Chapin, Flattau & Klimpl law firm, for putting on what I think, and from what I've just been hearing in feedback, is a really, really terrific panel.

I now want to introduce this next panel or at least the moderator of this next panel. Norma Levy, who is to my right, is counsel to Davis, Weber & Edwards. We tend to recycle our former Chairs, which I guess should be a lesson to me. Barry is a former Chair of the Section and so is Norma. Norma is going to present a panel on deregulation, and I think we're all looking forward to a subject that hasn't gotten as much public discussion on the antitrust front as I think it should have. Norma.

Deregulation and Antitrust Law: From Telecommunications to Electricity to Health Care—Creating a Free Market

NORMA B. LEVY: Thank you, Meg. I am, sad to say, old enough to remember that there was once a period of time—a substantial period of time—in which everyone *knew* that there were businesses that were natural monopolies. It was clear that the telephone company was a monopoly and would always be a monopoly, because that's what they were. However now, suddenly, they are no longer monopolies; they are being deregulated. Electricity, telecommunications and other areas, many of which were believed to be natural monopolies and all of which were intensively regulated, are now being deregulated and some form of competition is beginning to emerge.

There has, as a result, been an extraordinary amount of change in the regulatory arena over the last few years—change that in many ways seems to be intensifying rather than decreasing. That's what this panel is about. More particularly, it's about the relationship between the old regulated system and this deregulation—about going from a controlled price system to a free market system, and how this change impacts on the antitrust laws.

We're going to talk about that today in two panels. Our first panel will consist of four speakers who will share with you the nature of the deregulation in the particular industries in which they are involved and the effect of that deregulation on these industries. Two of the speakers are from the telecommunications industry—perhaps the most actively deregulated industry today; one speaker is from the electric industry, and one speaker is from the health care industry. The type of deregulation in each of these industries is different. You will get a sense of these differences and why they occurred.

At the end of this first panel, if we have time for questions, we'll take them. If not, we'll go directly into the second panel, which will be a more general discussion of what this deregulation is about and how it relates to the antitrust laws.

Our first speaker will be Roy Hoffinger. Roy is a graduate of Chicago Law School. Formerly with Cravath, Swaine & Moore, he is now Law Vice-President for Federal Regulation and Antitrust for AT&T, a long-distance carrier now seeking to enter the local telephone market. Roy is as actively involved in this telecom deregulation as anyone. He will be the first of two speakers on telecommunications deregulation.

The second telecommunications speaker is Alan Silverstein. Alan is a graduate of Georgetown Law School. He was previously a trial attorney with the Antitrust Division of the U.S. Department of Justice working on the *U.S. vs. AT&T* litigation many years ago. Today, Alan is a General Attorney with BellSouth Corporation in Atlanta. Bell South is a "Regional Bell Operating Company," or RBOC. Once a regulated monopoly, Bell South and the six other RBOCs are the local telephone companies that are in the process of being deregulated. Alan will give us a different perspective from Roy on the telecommunications deregulation issue, I'm sure.

Charlie Pratt, to my far right, is also a Chicago Law School graduate. Charlie spent twelve years as General Counsel to the New York Power Authority. Today he's a partner at the firm of Dickstein, Shapiro, Morin & Oshinsky and Chair of the Energy Committee of the Association of the Bar of the City of New York. Charlie will describe to us the area of electricity deregulation.

A very different kind of deregulation, somewhat unheralded, is the health care industry deregulation in New York today. Susan Waltman is a graduate of Columbia Law School and worked for several years in the health care industry. She is Senior Vice-President and General Counsel to the Greater New York Hospital Association, which represents the interests of 176 voluntary not-for-profit and public hospitals and long-term care facilities in the New York area.

Roy, I'm going to turn this over to you now.

ROY E. HOFFINGER, ESQ.: There's no doubt that Alan and I have very different perspectives, but I think we are going to agree to what I call temporary peace because for my part I think we're just plain old tired of fighting with each other. So I think we're going to try to use our time to give a more or less complementary overview of what's happening in the telecommunications industry.

There truly is an incredible revolution going on and quite a bold experiment in public policy and regulation, and I'm going to talk a little bit about the statutory and regulatory bases for the so-called revolution, and then I think Alan is going to discuss a little bit of the implications and how everything is changing and what that means for antitrust analysis and markets and so forth.

It's ironic in a sense that we're here to talk about deregulation because I appreciated Norma's statement that various industries are taking very different approaches, and I think I can't say if the telecom approach is unique, but I'm sure it is not emulated everywhere, and that is the thing that I think is concern-

ing most of our companies today, is that indeed we are driving towards deregulation, but the way we are driving to deregulation is through an additional intensive phase of regulation. Indeed, it could justifiably be described as more intense regulation than ever before, and that is because, in essence, what we are trying to do is to lay out the conditions that will allow for the creation of competition, and ultimately if and when that succeeds, we will have a competitive environment in the telecommunications market and more segments than ever before, and at that point in time we really can continue then back and ratchet back dramatically so on that regulation.

You know, the history of this, of course, is basically we all know about the Bell system. Alan, I guess, helped to break it up.

MR. SILVERSTEIN: That was then.

MR. HOFFINGER: A very long time ago.

And one of the things that happened to drive that of course was that the telephone company, the Bell system in particular, frequently was thought of as a natural monopoly. And the natural monopoly characteristic of the Bell system basically lay in what is often referred to as the last mile, and that is the wires, the copper cables that link each and every business and household to the public telephone system. And it was thought that that could never efficiently be duplicated, and that's what gave the industry its natural monopoly quality. At the same time, a number of firms began to realize that although they may not be able to compete and duplicate the last mile, they could provide facilities that basically traversed large central offices and, in essence, engaged in what was called the long-haul portion of telecommunications, otherwise known as long distance. And so you began to see your MCI's and your GTE's which became Sprint and ultimately it was decided that the Bell system—what the 1984 consent decree was about was that the Bell system had been using the last mile to basically preclude competition by these competing long-haul carriers, and that of course led to divestiture. And therefore, instead of everyone having one telephone company to provide both local and long distance calling, as we all know, they had two, and there then developed to be really two separate industries and two separate markets, the long distance market and the local market. And what we really had was extraordinarily continued pervasive detailed regulation at the state level of local telecommunications. I say state because it was deemed to be an intrastate service. It was always thought to be a natural monopoly, and it was regulated as such. At the same time both the states and the federal authorities continued to regulate long distance. But as MCI, Sprint and many, many hundreds of competitors entered the market, true competition did develop and the FCC and many of its state counterparts gradually, but steadily, reduced the regulation of the long-distance industry. I think the biggest single aspect of long-distance regulation during this period of time stems from the MFJ, which was the line of business restriction. This is the prohibition on the local Bell operator companies or regional Bell operating companies, including BellSouth, from providing long distance. And that happened in 1984, and there was a great deal of political and legal debate about the wisdom of the MFJ and the breakup. Was it a good idea from the inception? Is there time for a change? And that tremendous amount of debate ultimately culminated in what really has been engaging me for the last four years—it's been a great thing for lawyers, the Telecommunications Act of 1996. And that was designed to do two things. First, the argument was that we will no longer accept the notion that the local exchange and the so-called last mile is indeed a natural monopoly. Technology is changing; we're more innovative. Let's put in place a set of conditions that can really determine if this is indeed a natural monopoly, try to break it and get some competition there. And then the other aspect of it was if that can happen, there would be no economic or legal basis to prohibit the Bell companies from providing long distance service, and the line of business restriction basically can be removed and you can have up to seven very, very powerful driven companies entering what was already a pretty vigorously competitive long-distance market. But why not have even more? And then there was also a driver which is that, I think everyone always conceded that the split between local and long distance was kind of unnatural, and an awful lot of people would really prefer to have an option just to deal with one company as opposed to two. And all of these things came together and led to this massive piece of legislation, the first major overhall of the Communications Act since 1934, called the Telecommunications Act of 1996. It did two significant things. It's a huge piece of legislation. The first thing it did was that it eliminated explicitly legal barriers to entry into the telecommunications market. And that is, it immediately declared unlawful franchise restrictions and exclusive franchise ordinances that states and municipalities had conferred on the local telecommunications companies. So there were no longer any barriers to existing long-distance companies or new entrepeneurs coming in and trying to provide their own local telecommunications service. But, of course, that legal barrier does nothing about the economic and technical difficulties, including the characteristics that have been thought to render the local exchange a natural monopoly, and that is the enormous amount of sunk facilities that the incumbents, including the Bell companies in particular, have had invested in their networks. So probably the most critical thing and the really regulatory aspect of the Telecommunications Act was that it provided a number of means of entry other than just by building your own networks and digging up everybody else's front lawn. One was it permitted for the first time resale of the local telephone company's telecommunication services, but much more controversially, it required

them, in essence, to sell pieces, parts of their network, which actually could then be combined or obtained in combination and make them available to new entrants at cost-based rates.

Now as antitrust lawyers I'm sure you can just think and imagine the amount of litigation that these provisions have generated. Indeed, when the FCC took on the task directed by Congress, that is, to adopt rules implementing these provisions of the Act, just to establish the very high level rules and principles, to define, for example, what is a network element that has to be made available, what does a cost-based rate mean? That the FCC, just to adopt high-level rules, adopted a 700-page order that was litigated all the way up to the Supreme Court in a decision that was issued just about a year ago today.

There is a multiphase of implementation process, the FCC regulation, then state proceedings. Another wild thing about this scheme is that it called for this cooperative state and federal administration of this regime. There are just dozens, if not hundreds, of state and federal regulatory proceedings, all of which are initially intended to break the local exchange monopoly. And then once it's found that that monopoly has been broken and that there is local competition, or at least the possibility of efficient local competition, then a Bell company can come in and petition the FCC and request authorization on a state-by-state basis to provide long-distance service. People have been impatient. For some reason, people thought that within a year after Congress passed the Act in 1996, most people would have choices of local telephone companies and most people would be able to receive their long distance service from a Bell operating company. I think one of the things that Alan and I agree on is that expectations in these regards were excessive. This was an extraordinarily complex and difficult undertaking, and we have really just started to see some progress being made.

New York, interestingly enough, earlier this month became the first state in which a Bell operating company, Bell Atlantic, has been in fact allowed to provide long-distance service. You've seen all the commercials, Paul Reiser and so forth, and the whole predicate for that was a finding by the FCC that Bell Atlantic had done what Congress directed it to do and what the FCC directed it to do and then what the New York State Public Service Commission directed it to do, open its market and made, for example, its network available for use by others at cost-based rates.

So we see a tremendous amount of revolution going on. Markets are being defined; the distinction between local and long-distance is collapsing, and then there's a whole other area that I think Alan is going to get into a bit more, which is not only are we talking about differences in shifting markets in terms of local and long-distance calling but also voice calling and then data communications such as how we use the Internet, things like that. The revolution there is that voice telecommunications has been very, very heavily regulated. Data communications, on the other hand, in particular related to use of the Internet, has been virtually unregulated. The problem with that model is that as technology improves there really is no difference between the networks and facilities that are used for voice communications and the network and facilities that are used for data communications. So how then can we have these very, very disparate regulatory schemes? And with that, I would like to turn it over to Alan.

ALAN L. SILVERSTEIN, ESQ.: Thank you, Roy, and thank you, Norma.

Well, I'll cover as much as I can, and I promise to stick to the time, and I'll go over some things, and maybe we'll touch on them fairly briefly. I hope if there's time and interest we can cover them in the questions and even perhaps in the second panel we can explore some of these things in a little more detail.

Well, of course, Roy said there's a lot going on, and of course I agree with him about that. I think this industry is a very exciting one, particularly now. But what is it that's driving and shaping telecommunications competition? To me there are really four things. One is, of course, the 1996 Telecommunications Act, which I'll make a couple of quick observations on. I appreciate Roy's very fine description of that, and I'm not going to talk about the kind of workings of the Act unless we have specific questions. I do want to make a little plug for the little primer overview that I put together that's in your materials. It's not a new piece. I wrote it right after the Act came out, but I think it's still valid, and I hope you find it helpful. And even if you don't deal in telecommunications, at least you can see the model that they are using. It tends to go through at least the telecommunications portion of the Act in some detail.

Well, in addition to the '96 Act, I think it's perhaps no secret that technology is driving and shaping competition. And something that is probably very closely related to technology, the notion of convergence. Convergence is a word that you hear a lot, but I think it is a very significant concept, a very meaningful concept in virtually all aspects of telecommunications. I'll talk a little bit about that and maybe touch on some of the mergers that are going on these days.

Well, the only observation I want to make about the '96 Act, building upon what Roy said, is that from an antitrust practitioner's perspective, it is an interesting issue to me that in light of this very heavy blanket of regulation that Roy has been talking about, regulating massive minute levels of detail, basically what is left for antitrust? I think that's a fair question, and at least from my perspective in a number of areas I think the answer is maybe not that much. It's really on the regulatory playing field of the Act that is before the Federal Communications Commission that a lot of these basic issues are being

fought and resolved, not in the antitrust courts. Now, I don't think that's particularly surprising, and I think that's probably how it ought to be, given the regulatory structure that the Act has. But let me give you an example of what I mean about what's left, if anything, for antitrust in some of these areas.

Take a look at something like the Essential Facilities Doctrine. Now, with respect to a new entrant that's seeking access to the facility of the dominant local service provider, Bell company or others in this area, the Act—certainly the Act as interpreted by the FCC requires access to these so-called network elements that Roy talked about. He referred to them as selling piece parts of the network. But the things that the Act requires access to, the universe of things they require access to I believe go far beyond what the antitrust laws would require under the essential facilities doctrine. I don't think that is particularly controversial. I think the FCC recognized that in some of their more recent orders defining these sorts of things. In fact, I think some of the local operating companies who wanted to impose an essential facility doctrine overlay on the Act was a losing argument, and I think it was correctly seen as a losing argument. This goes way beyond the essential facilities doctrine. In fact, if you want to call it a doctrine, the approach taken by the Act is probably more accurately described as the "gee-that-sure-would-be-nice-to-have-doctrine." But I don't think there's anything inherently wrong with that if that's what Congress intended, and I think to a large degree it is what they did intend. But as a practical matter I think it trumps an antitrust essential facilities case.

Now independent of the '96 Act, another very important factor that's driving and shaping telecommunications competition is technology, and Roy began to talk about that a little as well. Now, you often hear it said that competition drives technology; that is, as firms compete, they have the incentive to innovate and compete in the technology realm, in addition to the other fronts on which they compete. Well, I think that's certainly true in telecommunications, but I also think that the converse is true. That is that in this industry technology drives competition. And now I'm referring to technology that was developed for other applications and was adapted for use in telecommunications. This is nothing new in this industry. The industry saw this right after World War II. It was in the post World War II time frame that the peace-time uses of radar technology that was developed for the war effort led to the development of microwave transmission of telecommunications that created companies, perhaps the best known of which is MCI and made the earliest form of long-distance competition feasible. Now we're also seeing the same kind of technology revolution with digital technology. It's transforming the way voice messages are transmitted. But one thing I want to note here is when I talk, in this sense, about the use of digital technology, I'm not referring here to this thing people call the digital explosion. That is the explosion in the amount of data that's actually transmitted as data. And by the way, that's a dramatic phenomenon itself, and the reports say that data traffic is on the verge of overtaking voice traffic perhaps within the next year or so—at least on a volume basis, not on a revenue basis—as the predominant traffic on the telecommunications lines. But I'm referring to the actual digital transmission of voice. The basic notion that bits are bits, if you can transmit bits, you transmit data, you can transmit voice.

I think I know one of the questions you're going to ask, so I'm going to preempt that. You're going to say with all this stuff about this digital technology revolution, can't they figure out a way to stop those computers from making that God-awful noise when they connect to the modems?

At any rate somehow they haven't gotten though that yet. But trust me there is a revolution going on.

Well, related to this technology concept is the concept of convergence, and when I'm talking about convergence I mean it in two senses. The first sense of convergence is talking about a blending of formerly separate services into one. The second sense is more competition. It's two services that are beginning to compete with each other. And for some examples, Roy began to mention a couple of these, we're beginning to see a convergence of local and long distance. That is, firms are beginning to offer and will be offering what MCI Worldcom is referring to as the all-distance service. In fact, the Worldcom Chairman, Bernie Eberz, announced that next month, right here in New York, MCI Worldcom is going to be coming out with an all-distance offering. Not just a package plan of some package of long distance discount and a local discount or whatever it is, this is a monthly fee for a bucket of minutes, 500 minutes or whatever you buy, that you can use and combine however you wish. You can use it to call next door or to call across the country. At any rate, they are referring to that as an all-distance offering.

I also think there is some very interesting convergence that we are beginning to see—and you'll see the same theme—it is local, long distance, wireless, wire line, voice, data, so on and so forth. Wire line and wireless convergence. Again that's happening in two respects. The first respect is as the rates go down for wireless, wireless services are competing with wire line. That is, people are taking wireless service instead of, not as a complement to their traditional land line service. I think we'll be seeing more and more of this. In fact, I think more and more, you'll begin to see phone numbers that are associated with people, not places. Now, of course you have your home phone, your office phone, your car phone, but I think you're going to begin to see numbers that are just associated with a person. When they are at the office they will be answering the number at this office, so on and so forth. That's one way in which it is happening. The second way in which there is a wire line-

wireless convergence is the use of a technology called fixed wireless as an alternative way of delivering local telephone service to the home. You can think of this perhaps as the third pipe to the home, the other two being the traditional telephone line of course and the cable television line. And of course AT&T has announced one of their strategies when they complete the AT&T-Media One merger would be to provide local service where they have their cable properties through the coaxial cable. So here's a third pipe to the home, and AT&T has also announced it is going to be using some fixed wireless as well. It is an important component of what MCI-Worldcom-Sprint would like to do if their merger goes through.

By the way, the fixed wireless used to be referred to as fixed mobile, which is an intriguing oxymoron. This industry, of course, is not only good at acronyms it is also pretty good at oxymorons. Fixed mobile was a good one; one of my favorites now is wireless cable. That's another good one.

So from an antitrust standpoint where does this get us? I think this is a very interesting question. To me perhaps one of the biggest questions we are going to face and that is what does this convergence mean for the definition of relevant markets? Now, and I'm hoping perhaps we'll be able to discuss this some in the second panel, I know I'm particularly interested in the second panel's views on this convergence market definition issue. But DOJ and the FCC face a very interesting challenge. I think most people would agree that convergence is happening and will continue to happen and move faster and it will grow wider. So we have a situation where we know what the world looks like today. I think we probably know what the world will look like in five to ten years, the new converged world. But now what do we do? What about the realm of short-term, one- to two-year time frame that DOJ looks at, for example, in its merger analysis? And that's where I think some of the difficult issues are.

By the way, this convergence is being argued right now, at least to some degree, by MCI Worldcom and Sprint in connection with their pending merger. They argue that we are already at the point where there are not separate local and long distance markets but rather a single market.

Well, along with convergence comes the notion of these firms, the new world telecommunications firms, providing the full array of voice, data, wireless, and video services to customers. And this is what is driving firms to try to find the right structure, typically through merger or through some other means for competing in this new environment.

I want to talk a couple of minutes about mergers, and I think that will pretty much do it for my time. But I just want to mention a couple of background things about merger view at DOJ and the FCC. And as you may know, in the telecommunications industry both of those agencies review the mergers under different standards, but at any rate they both review them. DOJ, of course, uses its § 7 standard: is the merger likely to substantially lessen competition? The FCC uses a public interest standard. Now, at DOJ, in order to block a deal, the DOJ has the burden to prove that the merger is anticompetitive. On the other hand, at the FCC, if you want to get a merger approved, the parties are required to show that their merger is procompetitive. So just kind of looking at the balance here, if you happen to have, let's say, a competitively neutral merger, you'd conclude that DOJ would let it go through; on the other hand, presumably the FCC would block the deal.

Also, traditionally DOJ does not balance anticompetitive harm in one market against procompetitive effects in some other market, particularly if the anticompetitive effect is substantial. If there's a problem in a market, if you can fix it, you fix it. The FCC, on the other hand, does show a dramatic willingness to undertake just that type of balancing. You can see this, for example, in the decision on the SBC-Ameritech merger. I presume you folks know they merged. It's not news. But at any rate, for a guy like me who finds something like that exciting, it was big at the time. Well, at SBC-Ameritech the FCC required commitments from the merged firm to enter various out-of-region local markets out of the local serving areas of Band Ameritech. So for example, Atlanta, Miami and BellSouth's region, other areas around the country required commitments to enter those out-of-region local markets on a specified time scale and with penalties if they don't enter in order to balance the predicted anticompetitive effects that the FCC saw in some of the in-region markets within SBC and Ameritech's local serving area. I think most significantly for antitrust lawyers that's probably the potential competition theory that SBC and Ameritech were seen as likely potential competitors into each others local markets. So obviously after the merger you've lost that source of potential competition.

Well, let me just list some of the big pending mergers that are out there, and I don't think we'll have time to talk about them right now. Of course I mentioned MCI Worldcom-Sprint. To me that's an interesting one because of some of the market and other issues it raised. Bell Atlantic-GTE is pending. AT&T-Media One, that I mentioned. I was away for a few days. I presume Quest-US West is still pending. But people are expecting a decision from the FCC fairly soon, and of course the one announced fairly recently AOL-Time Warner. I think to a greater or lesser degree they all tend to illustrate the points we've been talking about.

CHARLES M. PRATT, ESQ.: Thank you very much, Norma. Let me start by saying that I, as a concession to the season, am not in full voice. So I'll try and keep my voice level up.

In the outline I have given a very elliptical summary of the some of the events, some of the key elements that are happening in the electric utility industry restructuring, and I'm not going to rehash those in the time that's allotted to me today. In fact, rather than that, I thought I would talk about three issues that seemed to be pertinent to trade regulation, antitrust regulation.

Maybe one other note before I start on that front, for people who are particularly interested in the restructuring of this industry in New York, there is a document that the Energy Committee of the City Bar Association prepared about a year and a half ago, and it's available in a couple of electronic places. So if you're interested in learning more about the New York City and New York State restructuring, come up and see me after the panels are finished, and I can give you the address of that document.

So the three issues that I would like to spend a moment talking about are: first, does the adoption by independent system operators of market monitoring and market mitigation measures make any sense? And I would just make one other introductory comment. In every industry there are acronyms, and we have our share of oxymorons as well as the telecom industry, and I'm going to mention several times this afternoon the term "independent system operator" or ISO. In New England, New York, Pennsylvania and New Jersey (which we call PJM), and in California—four areas right now—the operation of the electric utility network is now under the control of independent system operators or ISOs. So a lot of what I'm going to talk about today are the ISOs. And for the people who have got the outline, there's a little bit of detail on ISOs included there.

First, does the adoption of market monitoring and market mitigation measures by ISOs make any sense? Second, is there an appropriate role for price caps in a competitive market? And then third: is there an apparent convergence, an increased industry concentration, and is this a problem?

Turning to the first of these three questions, I would like to start by saying that the restructuring of the electric utility industry doesn't only involve, fiscal or legal changes, corporate change, but it is also a reorganization of the basic markets, in the way in which electricity is being sold. In the traditional model, the electric industry had vertically integrated utility companies. Under the new model—and it already exists in this state; it's already in existence here, and it is in one way or another coming into existence in other parts of the country—one company will handle retail sales, a second company will handle the generation of the electricity and a third company known humorously or in a friendly way as the pipes and wires company will be the traditional last mile and basically own the transmission system. So these three companies in some areas could be affiliates in one holding company family or in some other situations they could be independent companies. In any event, the costs that were in the old model internalized in one company, the costs of serving the consumer, are now very much identified and allocated to specific companies through increasingly formal relationships between each of these different companies.

So in the context of this changing corporate environment the ISOs are imposing market mitigation measures—and I know that this has happened in the case of the New York and New England and California ISOs—very aggressive market power mitigation measures are in place. The imposition of these mitigation measures raises a number of questions, a number of issues.

First, let's ask the question: what authority does an ISO—which is not a governmental organization—in the case of New York I think it is a not-for-profit corporation—what authority does this not-for-profit corporation have to essentially levy fines and sanctions and penalties on market participants? Is this something that it can be appropriately delegated by the federal energy regulatory commission? Well, the answer, at least for now, is that the FERC has answered this question yes, in the affirmative. They have delegated to the New York ISO the ability to institute market power mitigation measures, and that could lead to sanctions or, in the right case, even penalties. But the issue of delegation of this kind of authority to a nongovernmental unit, an organization that's not a traditional regulatory body, it's not in any way a traditional antitrust regulatory authority, yet they are very much on a day-to-day basis enforcing the antitrust laws in this new emerging market.

A second issue that the imposition of these mitigation measures raises is what is the ISO looking for? Do they have the ability to find what's important? And what are they looking for? Because in this day and age, we've all got computers and the ISOs use computers to establish market screen devices. They are able to tell if you're bidding and they compare your bid today to an average of your last 90 days' bids. In other words, they compare your bid today versus this reference level based on an average of past bids. And they say, well, you are sufficiently above or below your reference level and that's a problem. So what they are looking for are incidents of what I'll call exceedance. They are looking for situations in which you are as a market participant bidding dissimilarly from the way you've bid in the past. That's not necessarily a persisting pattern. It is not a course of conduct. It's just what the screen tells as it detects one incident by one incident. So, the second question I'm raising is whether the ISO, assuming it has the authority to impose this sort of market mitigation measure, is looking for the right things; is it looking for sensible things?

The third issue is: are there due process questions here? I mentioned reference level; the reference level is based on the past bids that you, the bidder, have submit-

ted. But the ISO doesn't just compare your bid today with the exact average. They have an X factor; they have a percent of the reference level. So you have to be some percentage above or below it for the alarm to ring. But as a market participant, that difference between the regulatory threshold and the reference level, that's not a publicly available fact. In other words, the ISO is enforcing a mitigation scheme that is based on a set of private law. It's not only private in the sense that it's not governmental, it is also private in the sense the specific regulatory requirements are not disclosed to the people that are subject to the law. So this is a due process question.

Another due process question is whether there are any appeal rights. Well, the ISOs' answer is, "We have limited appeal rights, but you can try alternate dispute resolution." The short answer is that you, if you are a market participant that is trying to get the ISO to explain its intervention in the market, you essentially have got very few quick remedies in that kind of a situation. So the appeal rights are very deficient.

A third due process issue is what happens when the ISO errs in intervening in the market. Let's assume that—it won't happen very often, but let's assume at least once—the ISO makes an inappropriate call as to a market participant.They assert that there's a market power incident that needs to be mitigated, but that assertion turns out to be wrong. In other words the ISO errs in their intervention. Is there any remedy in dollars, any remedy that the market participant can achieve from the ISO? The short answer is no. The ISO has thought about this issue, and they said, "We don't want to pay any money to market participants," so even though they are able to assess fines and sanctions and penalties, the answer is, "There's no way, if it is shown that they are wrong, there is no way you can get your money back." So there are some significant, I think, due process questions.

Fourth, what's the standard? And this is one I can just identify—and the antitrust practitioners in the room can go farther with this—but what's the appropriate standard that the ISO should be looking at? Now, in a number of cases—and I know in California this is the explicit standard and I suspect that it is also going to be the standard in New York—the thinking behind all this is that the ISO is looking for all the bidders ultimately to bid their marginal cost of production. And so when you bid, if you're a generator and you bid higher than that, well, that's almost *per se* having exercised market power, because the goal should be marginal cost of production. And marginal cost, of course, is a traditional economical benchmark. So I can't say that the ISO is without some justification. On the other hand, there are other factors: geographical constraints, the electricity market is very geographically sensitive. The transmission system was built originally for—if we take the utility here in New York City—built for a utility in one city and one county. And if you look throughout the state, the same thing is true; the transmission systems are a series of locally based transmission wire systems. Now, in the 1970s and the 1980s there have been some building of transmission links that go in between company links, but they tend to be still stronger in the local area than they do on a statewide basis. So the result is there are transmission constraints. Particularly in New York, there are transmission constraints throughout the state. So geographical constraints are key.

Machine limitations are also important. Different generating machines respond in different ways. So you may bid for very valid purposes based on your machine's characteristics, because you want to use it in a particular way. And third, there may be long-term contract obligations that as a bidder either on the generating side or on the load side you've gotten that leads you to bid in a particular way. So I'm not at all sure that the ISO has got the ultimate economic standard correct.

Next issue: I've been focusing on the supply side issues; there are also demand side issues, in other words, on the customer side. Now, all of us as customers, either as individual customers or even if we think about the businesses we represent, in almost every case all of us as customers don't have to worry about this restructuring business. This is an interesting discussion we're having, but we don't have to worry about it because we end use customers pay a tariff rate. Our rates do not go up and down on an hourly basis depending on what's happening in the market. There is, in fact, an hourly market fluctuation, but it doesn't affect us as customers. And the question is: isn't it a necessary part of restructuring to expose all market participants, including end use customers, to market risk? And the answer, for a lot of people, is there eventually needs to be, at the customer side as well as on the supplier side, there needs to be market price fluctuation as well. And that's an issue that is not in any way being addressed today but is a down-the-road issue.

So as to this first of the three issues that I want to touch on, I guess I'd say that the systems for imposing market power mitigation measures are being justified as necessary to get the ISO restructured market started. In other words, if there are market design problems today we shouldn't worry because it is a transition issue. Eventually we will get to pure competition, and you won't have to have market power mitigation, or if such authority exists it will never be used. On the other hand, in the case of California, the California ISO has been in business now for over a year. They have recently obtained from the FERC authority for yet another year of price caps. They have price caps in California, and they have gotten another additional year of price cap authority from the FERC. So for people who say market design flaws are

only a startup transition issue, and once the market gets going it is going to fly without all this, I am concerned that that's not really going to happen.

I'm getting a signal from Norma that I've got to stop. I will just mention briefly the major second issue which is price caps. As I mentioned, price caps do exist, and they are totally inconsistent with the idea of a free market. But they are something that the ISOs in New England and in California have insisted on and they are insisting on to some extent now in California without any reference to the startup aspect. It's not just a market design issue; they just need the price caps.

Finally, let me just mention that there is a tremendous amount of merger and acquisition activity going on, and this is leading to the size of the companies in this business growing as a result of consolidation. The wires companies, for example PECO and Commonwealth Edison in Chicago or here in our own home town, Con Ed and Northeast Utilities in Hartford, the wires companies are getting bigger.

The generating companies are also getting bigger. The number of companies who are buying nuclear power plants—and nuclear power plants are being sold these days. There are two companies buying now, and as I mentioned in the outline, two others are in the wings thinking about buying. We may end up in a very few years with two to four companies owning most of the nuclear power plants in this country. There is a potential for some significant increase in the size and concentration of power in individual players in the market.

So these are three issues that have market power aspects, all of which are being thought about not in the format of an antitrust lawsuit, but they are being thought about very much by the regulators and by those subject to regulators' interests.

And with that I will acceed to the suggestion from the Chair. I will be happy to answer any questions during the question period.

MS. LEVY: Thank you, Charlie.

SUSAN C. WALTMAN, ESQ.: I will begin by providing a thumbnail sketch of the health care industry in New York State and New York City in particular. My perspective is obviously from that of an attorney in an advocacy position for an association of hospitals and nursing homes. GNYHA represents 176 hospitals and nursing homes in the New York City area, all of which are not-for-profit or public institutions. None of our members is for-profit because New York State law places significant limitations on the entry of for-profit health care in the hospital and nursing home arena. It is a unique industry here, a statement that I assume Washington, the Governor, and the Business Council are tired of hearing. But it is nevertheless quite unique.

By way of background, most of our 100 hospital members are teaching hospitals, which means we have everything the public wants when it comes to health care but that no one wants to pay for. And that's a real problem. Teaching hospitals, as you may know, provide very advanced care due to their affiliations with medical schools. These affiliations bring medical research, cutting-edge technology, and training programs for residents. Together, these features mean that patients receive state-of-the-art health care. But it also means the care delivered is more expensive than that provided in community hospitals, and that has been the focus of the debate for the last several years. No one really wants to pay for the cost of state-of-the-art care but everyone wants it when it comes to their own health care.

From a payment standpoint, New York State had historically regulated the rates of payment by all payers except Medicare, which has its own regulated system of reimbursement. Thus, through 1996, the state regulated the rates of payments for Medicaid and for all private payers such as Blue Cross plans and commercial insurers. The only entities that were allowed to negotiate prices were the HMOs, and they did not exercise that right for many years. When HMOs did start negotiating, many of the arrangements were not particularly favorable to hospitals because hospitals thought HMO patients represented only marginal revenue. So, as the HMO penetration increased, those contracts became quite damaging to hospitals in certain cases.

The historic regulated rate system—which now looks pretty good to many of us—actively discouraged competition. Hospitals had no ability to build reserves or to build for the future, given that the rates of payment were just enough to cover hospital costs. As noted, the system controlled the cost of care for private payers by imposing a cap on what private payers could be charged. This cap accrued to the benefit of private payers and arguably therefore to consumers, but hospitals suffered financially in the end.

As a result, hospitals in New York State have had the worst margins in the country, the worst ratios of all sorts, and the worst ability to gain access to capital. When the current Governor took office, there was a proposal to deregulate hospital rates. At that point, hospitals were already experiencing poor financial conditions, given the tight rate regulation, and many hospitals were concerned about the prospect of negotiating with payers. There were four goals that the Administration put forward as the system deregulated: it believed that deregulation would lower prices, improve quality, reduce perceived excess capacity, and interestingly strengthen hospitals' financial conditions.

There were about three days—and only three days—during which the State Commissioner of Health commented that the payers were complaining that hospitals were not negotiating with them, that the hospitals were

hanging tough, and the Commissioner requested hospitals to please negotiate. But that lasted for about three days, and then hardball negotiations began. Hospitals found, as the negotiations moved forward, that there was a total change in approach to payment. The state's regulated reimbursement system had been a case-based reimbursement system under which an efficient hospital that could safely discharge a patient faster, might benefit from the payment formula. However, under the deregulated system, the private payers wanted to pay for hospital services only on a per diem basis, which meant that hospitals would gain nothing from their efficiency. Hospitals nevertheless felt forced to negotiate per diem rates, which, from a hospital perspective, were negotiated based on certain assumptions as to how long patients might remain in the hospital, how fast hospitals would be paid, etc. However, the HMOs began to deny payment for many medically necessary days, and there were long delays in payments to hospitals. So hospitals found that their per diem pricing, which they had calculated would cover their costs of delivering care, fell short due to the payment practices of many managed care organizations. I would agree that there may be room for hospitals to do a better job of negotiating in certain cases, but the deals made were entered in good faith by hospitals based on certain assumptions. It became clear that the good faith may not have been shared among the payers.

Before moving on to discussing whether the goals of deregulation have been met, I would like to focus on the concept of "market power" within New York State's hospital system. Some might imagine that the hospital networks that have been forming must have significant "market power." Yet, I have sat through discussions of our lobbying positions or possible litigation, and it is amazing how little market power some of our hospitals believe they have. In fact, some are afraid to address managed care abuses due to fears that the plans will steer patients away from their facilities.

I would suggest that the goals of deregulation that I have outlined have not been effectuated. In particular, it is interesting that anyone could think that a market-driven approach in New York State could lower hospital "prices" and not negatively affect quality. This is due in great part to the fact that a significant number of individuals who enter our doors do not pay for the services they receive. The state of New York and the New York City area in particular have a large number of uninsured individuals: 28% of the under 65 population in New York City is uninsured. Clearly, hospitals cannot negotiate prices to cover the cost of delivering services to each patient when a large portion of the individuals to whom services are delivered have no ability to pay. This situation is made worse by the fact many of those who can pay, do not want to pay for those who can't. So there is a large portion of our patients to whom we must and do deliver services, which is indeed our charitable mission, but from whom we receive no payment for services rendered. Although our deregulated system contains certain supports to cover some of these uncompensated services, the system vastly underpays for what hospitals actually provide.

On the issue of quality, I would suggest that when hospitals are significantly underfunded, as we are from the standpoint of many of the payers, it is difficult, if not impossible, to improve quality or to compete from a quality perspective.

With respect to excess capacity, we are moving in the direction of reducing beds, but there will always need to be some excess capacity built in to accommodate flu season or other health problems we experience. For example, the AIDS epidemic caused us to add beds; with advances in AIDS treatment, we began eliminating some of those beds. Now we are seeing some of the patients who were being treated on an outpatient basis for AIDS returning on an inpatient basis. It is very difficult to anticipate bed need precisely.

In terms of strengthening our financial condition, it has not happened. Hospital bottom lines have only deteriorated further. On this point, you may have read about some of the recent successes of the hospital industry, such as certain reversals of BBA cuts. However, those successes represent only the mitigation of planned cuts and not new money and only serve to stabilize hospital financial conditions for the short term.

One last comment: as we have embarked on this deregulated reimbursement system that isn't working very well for hospitals, we at the same time have experienced increased regulatory requirements. These requirements are important to the quality of care that we provide, but they do cost money. So, for example, we are challenged to reduce medical errors by half by the year 2005, and to eliminate disparities in health status based on race and ethnicity—not necessarily of our own doing—by the year 2010. However, there is no new funding stream attached to these expectations but rather only more pressure to get our costs down. I would suggest that, in the end, what we really want as consumers is high-quality care, but this means that there must be appropriate levels of funding to support that care. The payments simply must be commensurate with the health care quality that we expect. Given the large number of uninsured individuals in New York State, neither a competitive market place nor an underfunded system will permit that level of care to be provided.

MS. LEVY: Thank you. Well, I certainly learned a lot about these industries that I didn't know about. And with this background in mind of the varying experiments, if you will, attempts at deregulation, we're now going to switch gears and talk about what all this means from an antitrust perspective.

We're fortunate to have with us today three experts, two very well-known and prominent lawyers and a very

well-known economist, who specializes in regulatory matters who will attempt to put some perspective on these changes.

It is my privilege to introduce the panel to you. On my right is John Nannes. John Nannes has spent many years working as an antitrust lawyer, including spending over 20 years working as an antitrust partner at the Washington office of Skadden Arps. And today, Mr. Nannes is serving as Deputy Assistant Attorney General in the Antitrust Division of the Department of Justice. He's also, I will add, doing double duty today because he is going to be our dinner speaker this evening.

On my far left is Harry First, who is a graduate of Pennsylvania Law School and has taught law at a number of educational institutions inside and outside the U.S., most recently NYU. He's a prolific writer with dozens of publications in this area. And as of July, as I'm sure most of you know, he has been serving as Chief of the Antitrust Bureau in the Office of the Attorney General of New York.

And to my immediate left is Alfred Kahn, who is the Robert Julius Thorne Professor of Political Economy Emeritus at Cornell University and a special consultant to the National Economic Research Association, which many of us know as NERA. He has a doctorate in economics from Yale, served on many boards and commissions and has been a prolific writer in the area of regulated industries. He's previously been Chair of the New York Public Service Commission, Chairman of the Civil Aeronautics Board and is as informed about these issues as anyone around.

We'll begin this second panel with Fred Khan, who will start with a brief analysis which will be a springboard for discussion on deregulation and its relation to antitrust.

DR. ALFRED KAHN: I'm going to slice this topic lengthwise—cutting across industry boundaries—rather than sideways, and make up for the consequent superficiality by a lack of depth.

Norma has already identified some of the questions common to these several industries. Now that we have seen them in industry-by-industry perspective, I will once again underline the common aspects and issues.

The first common question is, are there any natural monopolies any more? Obviously the answer is supplied by technology; and technological change in recent decades—which of course has varied and continues to vary in its character and intensity from one industry or industry segment to another—is what has made the question highly pertinent.

It appears that access to the basic telephone subscriber network still carries with it sufficient monopoly power in most parts of the country to make it still something of an essential facility; but, of course, we will never know until we stop cross-subsidizing basic residential rates there or substitute the competitively-neutral means of funding the subsidy promised by the Telecommunications Act of 1996. Observe, moreover, the dramatic increase in the use of fixed or even mobile wireless, the acquisition of cable companies such as TCI and MediaOne by AT&T, and the fiberoptic rings of competitive wireline carriers: "natural monopoly" may be disappearing before our eyes, although it's not entirely gone yet.

On the other hand, we used to think that long distance telephony was a natural monopoly because it seemed to require heavy investments in terrestrial facilities, prohibitively costly to duplicate and exhibiting unlimited economies of scale. Beginning with the introduction of the microwave 40 years ago, technology undermined that conception: the monopoly that was natural yesterday is no longer natural today.

In the electric field, we still think that there are natural monopolies in the wires. But just consider what's likely to happen if fuel cell technology continues to progress: distributed generation is the enemy of the wires. Meanwhile, however, we still have to worry about the access of competitors to those facilities.

Similarly, we used to think generation was a natural monopoly. It looked as though the size of the most efficient plant was increasing inexorably, year by year, and that the trend was bound to continue. That conception was subverted in the '70s—the industry was increasing the size of its generating stations beyond its ability to manage them efficiently; the cost of huge baseload nuclear plants grew almost out of control, it seemed; and in the '80s, combined cycle technology, along with the collapse of natural gas prices, totally changed the situation: a combined cycle gas turbine can be built at a relatively small investment cost and in much smaller units than were contemplated a decade earlier—100-megawatt rather than 1,000 or 1,500 capacity. And if the industry wasn't naturally competitive before, it is naturally competitive now—*provided* we devise the institutional means of constructing optimal transmission facilities and, with the dissolution of vertical integration, some other way of optimally integrating investments in generation and transmission—provisos that do not seem fully satisfied as yet.

Technological change means we have to be very careful about the ways in which, and the extent to which, we require the incumbent putative monopolists to provide their competitors access to their facilities in order to make efficient competition possible. We had better be certain that we do not impose sharing obligations or set terms for sharing that themselves discourage risky investments in innovation by both incumbents and potential entrants: the more favorable the terms and the greater the ease of access to those facilities by others, the

greater the encouragement to free riding and discouragement of facilities-based competition—a very real danger inherent in the way in which the Federal Communications Commission has gone about administering the provisions of the 1996 Act.

This consequence of technological change is not unidirectional, although I would think its natural tendency is to undermine previous technologically dictated "natural" monopoly. The development of computerized reservation systems in the airline industry in the 1980s and the use of them by the dominant carrier-owners in such a way as to deny nonCRS owners equal opportunity to compete, seemed by common consent to require some sort of correction if competition were to survive. I can recall testifying before congressional committees urging them to consider requiring the carrier-owners of CRSs to divest them; the ultimate outcome, instead, was DOT rules mandating fair and equal access.

That same issue recurs as we move from franchised monopoly to what we hope will be a regime of effective competition in all of these industries. Wherever there is still natural monopoly in some part of an industry, accompanied by vertical integration, and deregulation of other parts, the question arises of how to ensure access to the essential facilities—truly essential, according to historical antitrust standards—on terms that permit nonintegrated firms to compete on the basis of their relative efficiency with their vertical integrated suppliers of those essential inputs. The MFJ was obviously the outstanding example of going all the way to vertical divestiture, accompanied by prohibitions of monopoly suppliers operating also in competitive sectors. The alternative is to rely on rules of conduct prohibiting anticompetitive practices, such as tie-ins, direct or indirect, discrimination in access, cross-subsidizations and the like. And if we rely on rules, to what extent should they be enforced by the PUCs, to what extent do we simply turn responsibility over to the antitrust agencies?

So, common to all these industries is that fundamental structural decision. But even if the choice is divestiture and complete vertical separation, such solutions can never be once-and-for-all, particularly in the presence of rapidly developing technology. All through the life of the MFJ, there has been controversy about whether and when it was time to relax the complete vertical separation that it embodied—i.e., relax the technologically arbitrary line of business restrictions that it contained.

The original purpose of the AT&T divestiture has clearly been achieved. We now have a powerful, competitive (how imperfectly is still a subject of controversy) long-distance business independent of the local monopolies and totally free of danger of being taken over by them by abuse of local monopoly power. There is simply no way that the RBOCs could today, if they were free once again to enter the interLATA business, actually drive AT&T or MCI out or engage in successful predation—in a market in which an immense investment in facilities has already been sunk and marginal costs of continued operation virtually zero. The Telecommunications Act has, however, grafted a second purpose for retaining the interLATA prohibition—namely, to ensure cooperation by the Bell companies in opening their local markets to competition, as the price for being relieved in turn of the prohibition of their entering long-distance markets.

Similar issues have arisen in the deregulation of the electric utility business. In New York State, for example, the PSC has effectively required full financial separation of the regulated transmission function from generation; other states have simply relied on the structural arrangement of an independent system operator (an ISO)—a neutral agency, independently managed, with a mandate to provide equal competitive access to the transmission network—without necessarily requiring financial separation or divestiture.

So long as vertical integration persists, there will necessarily be controversies about the applicability of the essential facilities doctrine and the criteria properly to be applied in deciding what facilities or inputs incumbent monopolists should be forced to share with competitors. Nowhere have these controversies been more intense than in communications: witness the intense controversies over the FCC's definition of network elements that have to be made available to competitors. I don't know of anybody today who denies the need to require the local telephone companies to make their unbundled subscriber loops available, even though there may cease to be such a need in a few years. On the other hand, the Supreme Court in January of 1999 reversed the FCC's decision to require sharing of all elements that could feasibly be shared—clearly going far beyond any antitrust conception of essential facilities—in a decision by Judge Scalia and a brilliant concurrence by Stephen Breyer. The FCC has remained essentially defiant, although it has begun to recognize that where the network elements subject to possible sharing obligations involve risky investments in new facilities, embodying a large element of innovation, it has to be very careful about imposing requirements that the successful innovators share their facilities with competitors.

The same issue has turned up in the controversies over AT&T's acquisition of TCI and Media One: other providers of telecommunications services and in particular of Internet services began almost immediately to demand the right to share the high-capacity facilities of the acquired cable companies. The same issue arose of whether the local telephone companies should be required similarly to share the XDSL capabilities that they have begun to incorporate in their access and transmission lines, permitting similar high-volume high-speed transmission of data, including Internet access. In this

case, the FCC did wisely decide to withhold its legislative hand. But in other respects, the Commission has almost certainly erred on the side of an excessively pervasive requirement of sharing.

At least equally controversial is the issue of how the prices for those network elements are to be set—an issue still on appeal to the 8th Circuit Court. The FCC has prescribed an absurd basis for them—the estimated minimum cost of constructing entirely new facilities from the ground up, with maximum efficiency. I'll have to content myself with the observation that I have spelled out my criticism of that rule at length elsewhere.

On the other hand, the essential facilities doctrine, strictly defined and applied, as it is in antitrust jurisprudence, really doesn't work in a situation in which the advantages possessed by the incumbent utility companies are not the consequence of superior enterprise, but merely the carryover from the period in which they enjoyed franchised monopoly. Remember the explication implicit, at least, in the *Alcoa* decision of the reason for defining such essential facilities strictly: competition consists in a quest for advantage; if every time some competitor succeeds in that quest, the law requires it to share the source of that advantage with rivals, because inability to obtain access to it would "impair" their ability to compete (in the language of the Telecommunications Act), the result is to discourage the process of competition itself: as *Alcoa* put it, the successful competitor, having been urged to compete, and so on.

Where, however, the advantage is simply the consequence of an inherited franchised monopoly, it seems to me one can make a logical case for mandatory sharing: it involves no penalty for superior enterprise or innovation. I hasten to recognize that such a rule raises complicated questions of the feasibility of sharing, of defining what must be shared and what not and on what terms. On the other hand, confronted with a strong tendency of regulatory agencies simply to prohibit utility companies exploiting potential economies of scope by sharing any of their facilities, equipment, billing, computing capability with unregulated affiliates—in short, to handicap the incumbents in order quickly to produce results in the form of real live competitors, a commitment by the incumbents to share some of those advantages with competitors, to the extent feasible, may help persuade commissions not to err so far in the direction, familiar to anyone involved in antitrust, of encouraging and protecting competitors at the expense of the competitive process itself.

Another problem pervasive in all these industries is the wave of mergers set off by deregulation. The introduction of competition creates extraordinary pressures to merge, for reasons good and bad, and evaluating them in those circumstances—particularly in the context of a rapidly changing technology—presents extraordinary difficulties.

An alternative approach to total divestiture or flat line of business prohibitions adopted in many jurisdictions, particularly in electric distribution, is simply structural separation, separate corporate arrangements with separate books of account, to detect and prevent cross-subsidizations, accompanied by codes of conduct the purpose of which is to approximate what the antitrust laws would achieve.

That raises another pervasive issue: which agencies are to be responsible for the preservation of competition in deregulated industries? I think the predilection of most of us would be to get the regulatory agencies out of that business, because they tend to be cartelistic and excessively interventionalist, with a strong tendency to try to handicap the competition and to commit the ancient antitrust sin to which I have already alluded of confusing the protection of competitors with the preservation of competition. But the issues of how best to preserve competition in the public utility industries in process of deregulation—short of outright divestiture or line of business prohibitions—are so complicated, require such continuing auditing of inter-affiliate transactions, and the presence of essential facilities and the consequent need for stipulating what must be shared with competitors, at what price so pervasive, it is difficult to see how the antitrust agencies could possibly carry the burden.

There are in the public utility industries the additional complicating factors of pervasive continuing regulation of some retail rates, particularly to residential customers, widespread, deliberately imposed cross-subsidizations—particularly of basic residential telephone service, at the expense of so-called vertical services, charges to business and long distance—and the necessity for monitoring the recovery of sunk costs of incumbent utility companies that are threatened with stranding in the face of competition. It is hard to see how the regulatory utility commissions could simply be dissolved in the manner of the late, unlamented Civil Aeronautics Board.

On the other hand, the strong inherent tendencies of commissions to over-regulate and mis-regulate, so long as they are held publicly responsible for the outcome, suggests that in a second- or third-best world, simple total deregulation, leaving the industries to the scrutiny of the antitrust laws, may well turn out to be the best choice. The attractiveness of this "final solution" is increased by the realization that the "cross-subsidizations" of unregulated at the expense of regulated activities (and purchasers of regulated services) and the consequent assumed necessity for intense regulatory scrutiny of all inter-affiliate transactions is itself in a very real sense the unique product of regulation itself: In unregu-

lated industry generally, there is no reason for sellers to price the putative cross-subsidizing services at anything but their profit-maximizing level—a level that is not increased by a decision on their part to sell competitive services at prices lower than they would otherwise do. It is only so long as the prices of some of their services continue to be regulated that companies may possess a reserve of, as yet, not fully exploited monopoly power, which they may be enabled more fully to exploit if their competitive operations show losses. Here, it seems, is an example of the secret of perpetual motion: regulation appears to be necessary in order to guard against a malpractice that makes sense only because of the continuation of regulation!

But none of this takes care of externalities—a failure of the competitive market exemplified by our previous discussions of both the electric and the health industries. In the former, reliability is supplied by that entire system. To the extent all suppliers must rely on backup capacity supplied by the entire system, there is an inherent temptation for each to free-ride on the reserve margins provided by others. The only way to avoid this is to have some agency that apportions the costs of maintaining that collective good among all beneficiaries on an equitable basis.

It appears clearly from one of our other presentations that this is also the teaching hospitals' problem, almost precisely: what comes out of them is beneficial to everybody, but nobody wants to pay for it. In a purely competitive system it won't be paid for: there has to be some collective means of apportioning those costs in order to achieve the collective benefit.

I think I've thrown out enough common problems; I am happy to leave the solutions to you.

MS. LEVY: John, maybe you'll have some comments on that from an antitrust perspective.

JOHN NANNES, ESQ.: I'll be happy to. Harry and I were trying to figure out who should go in what order. I suggested Fred, and the good news was he covered everything, and the bad news was he covered everything. So there's not too much to be added here, but I'll try nonetheless.

I had occasion to read two things in the last couple of days that were separated in time by about 25 years, and I was really struck in certain respects by the similarity and in other respects by their understandable differences. Twenty-five years ago I was in New York on the occasion of this Association's dinner and heard Tom Kauper give a speech called, "The Case Against Regulatory Reform by Free Enterprise Advocates." And in it, Tom expressed considerable concern that the kind of undifferentiated support companies had enjoyed for some years was being dissipated as companies had to confront the reality of possible actual deregulatory legislation and deregulatory administrative rules. He was concerned that the companies defending the status quo of regulation were going to prevail over those people who had a generalized understanding of the benefits of competition but didn't have particularly the vested interests to stand up and support them. And at that time, he urged the antitrust bar to understand the benefits of competition, to play a leadship role. And interestingly, at the time Tom was concerned about the deregulatory initiatives to relax CAB jurisdiction and relax ICC jurisdiction, which—at least for some period in 1976—seemed to be languishing.

I contrast that with an article that I saw in today's *Wall Street Journal*. I don't know if any of you had a chance to take a look at it. It is called "The 17-year Boom" and was written by Lawrence Lindsey who used to be on the Federal Reserve, and he says obviously something started in the 1980s that energized the economy like never before. What was it? Markets were simply allowed to work. I think he talks about the critical change in economic thinking, and he says in the 1970s the capture theory of regulation challenged the regulatory regimes that had dominated many major American industries. Successful deregulatory experiments in transportation serve as a model for other industries, including finance and energy.

When I compare the rationale that Lindsey used this morning, and the courts used 25 years ago to argue in favor of competition and in favor of deregulation they are quite similar. But when you compare the kinds of industries that Tom was talking about in 1976—air and motor—and the kind of industries the panels are talking about today—last mile for telecommunication services and local wires for electricity—it is mind-numbing how far we have actually come. And I think Fred is exactly right, it is technology. But you can think about it, you can speculate about it, but there's no way to stop it. And it really is technology that is ultimately the only defining limitation on the extent to which over the long run we are going to substitute competition for regulation.

Now, to build on a couple of things that I think Alan talked about earlier and Fred mentioned toward the end of his remarks, let me make a couple of comments about mergers in this area. As you know, there is overlapping jurisdiction in a number of major basic industries with respect to merger and acquisition review. The STB, as successor to the ICC, still has exclusive jurisdiction over railroad mergers. The Justice Department has had competitive concerns about the railroad industry; we have to take them to the STB in the context of its acquisition proceedings. For some years, the DOT was the executive branch agency with review over airline mergers so, like the STB, we had to take our antitrust concerns to the DOT, and the DOT made the final decision. If we were concerned about a merger like Northwest-Republic or TWA-Ozark combining two hubs, we opposed them, and the DOT said, "Thank you very much, we are approving

them; we control the parking spaces, and this car is going to park right here."

Then there are agencies like the FCC which has this broad public interest review. The contrast over the years is really quite remarkable. Back in the '70s and '80s, the principal antitrust concern was that regulatory agencies were going to approve transactions the antitrust laws would have intervened to stop. As Alan mentioned to you, we have something quite different now, circumstances like those at FERC and FCC, where issues are being raised about whether those agencies ought to impose limitation conditions, requirements that go far beyond anything that we would seek to impose by way of court order if we were to bring a merger challenge. Some people have questioned whether that's desirable or not. There are some FERC commissioners now who say those agencies ought to get out of the merger review business, or—at least—antitrust locus with respect to merger review should be exclusively in the federal antitrust agencies. And that's a debate that I think traverses over some common ground. At least when we do an antitrust review we try to ground it in economics. If you are going one step beyond economics and take into account other factors, what is the limiting principle? And when you see some of these agencies impose conditions, some people say it seems almost whimsical, though obviously they weren't whimsical to a majority of the commissioners imposing them. You have to wonder, what is the limiting principle?

There are differences that flow from Antitrust Division review versus regulatory agency reviews. There have been proposals from time to time that the STB ought to sunset its merger review. One of the things you have to take a look at is what kind of conditions the STB has historically imposed on railroad mergers, and how that would change if it lost authority over mergers to the antitrust agencies. If you have two railroads combining, assuming they have sufficiently complementary operations that you don't think you ought to interfere with the transaction in its entirety but they have some overlapping operations, the STB is ordering some kind of conditions in the form of trackage rights or reciprocal switching agreements to allow some third-party carrier to come in and operate its trains over the tracks of the now combined entity. Well, as Fred alluded to, that is a matter that requires a good deal of business relationships on a going-forward basis. Who is going to prescribe the rates? Who is going to make sure in the dispatching yard that the carrier that owns the yard is sending its cars out on a no more preferential basis than it is willing to send out the cars of the tenant railroad pursuant to trackage rights agreements? That is not the kind of thing that we frequently ask courts to do.

You can say whatever you want about Harold Greene. I think most people think very highly of his efforts to administer the telecommunication industry under the MFJ, but very few people think on a going-forward basis that that is the long term solution in a competitive industry. So in a railroad or telecommunications context, the question arises: are the antitrust laws able to impose conduct remedies? And, if not, if jurisdiction is going to be transferred to the antitrust authorities, then what the antitrust authorities have to do is some of the hard thinking that Bob Pitofsky has described recently about divestitures. There may come a time when you have to simply say no, and not let a transaction proceed because you haven't got a remedy.

Final point, just to make an observation. I know everybody talks about globalization and you get tired of it after a while. But there is one aspect that relates to antitrust. There can't be an antitrust lawyer in this room who has done a merger-acquisition recently that hasn't had to deal with the growing proliferation of antitrust merger reviews. At last count there were 40. That was a couple of days ago. There could be 70 today. They are growing at an enormous pace. Some are seeing them as a revenue option; others see them as national champion kinds of issues. There are ongoing efforts important to American companies to try to move towards some kind of convergence and some kind of limitation on merger reviews, so companies don't wind up pouring millions of dollars into what are essentially overlapping and duplicative merger investigations.

But there is an issue about the credibility of the United States going into that forum and trying to argue for streamlining the merger process. You can't sit in a room with competition authorities from around the world and explain to them in a rational way, oh, yes, well, there's a federal antitrust law, but even if the Antitrust Division decides not to challenge the transaction, the states may. And even if the states don't and we don't, there's always the Federal Trade Commission with whom we have to liaison to make sure only one of us takes a look at the transaction. And there may be other agencies with review authority. So if we are going to streamline this process, it does require something of a fresh look to the extent we are going to have overlapping and duplicative merger reviews at the federal level and to a lesser extent at the state level.

HARRY FIRST, ESQ.: One of the benefits of going last is you get the last word. The drawback, besides standing between you and the bar, is that everyone has said everything already. If I had answers, I would give you them all, however, I just have more questions.

I should just tell you, I taught one semester with Fred Kahn, which was the easiest semester I ever had because he knows everything about regulated industries and could just take the whole seminar, and it was great, and this was a nice replay of that.

But I thought what I'd try to do as the final speaker is to say something that everyone said, and just try see if

we can put this all together and see what themes come out of the day. And I've set my goal to see if I can bring this all back to *Microsoft*. I say this only as a half joke, because in some ways there are themes here in the discussion about deregulation which do echo some of the issues and problems that we see and face in the Microsoft litigation.

So I'll start with one point that everybody mentioned. I thought I was being really brilliant when I wrote this down last night and the first speaker said it, the second speaker said it, everybody said it: the force of technology. The technology is a driver here in the industries we are looking at. We can see it in health care, in the increasing costs of certain kinds of technologies and how that has to affect the structure of the market. Obviously we can see it in telecommunications. We see its effect in the electric power industry, in transmission lines and the kinds of new generating capacities that have come on line. So technology is obviously a driver.

But it's so easy to get carried away with these things. We still don't have the Dick Tracy watch, or the things we had predicted we'd have in 2000 in the *Jetsons*. We don't teleport ourselves. Someone joked the way to understand technology is that everything that has a wire won't and everything that doesn't will. So your phones become cordless, and your television gets a wire, and I don't know what to do with fixed mobile phones. So technology is obviously very important, and the technology of increasing importance, is, of course, the Internet and how that's going to end up restructuring things. It's important, but just let's not overstate it, and let's be a little cautious about it. And I'll bring it back to *Microsoft*.

Microsoft involves a new technology in some sense, but the problem can be analyzed through the traditional analytical tools of antitrust and microeconomic theory and maybe some new economic theories. It doesn't necessarily throw us for a loop.

The second general point that I think ties things together is a renewed belief in market mechanisms. A lot of what has moved deregulation—and now deregulation means a lot of different things in different industries and it goes at different paces—but a lot of what has moved it is this general belief that market forces are a better way of organizing the economy, and I think it goes to the piece, John, that you read. Wow, we've had this deregulation, isn't it great? We shouldn't ignore the slight shade of disappointment that sometimes goes with it. I heard it when Susan talked about health care. We've had this deregulation, but there are shifts, costs, as things are moved around, as subsidies that were internalized get revealed and can't occur anymore in a market, so there can be disappointments.

The Telecommunications Act of 1996 is a great example of this. The expectations of what opening up the ability to enter markets will actually mean may exceed what really happens. Do we remember? We thought the cable system will be a phone company, the phone company will be a cable system. Everyone is going to be long-distance. Everyone is going to penetrate everyone's market. No one moved for four years, and it's starting to move now, but it really took a bit of a while.

The third issue that people did raise—and it was raised a little indirectly in the first panel and maybe little bit more directly just now, particularly by John—are the institutional issues that play out in deregulation and which become important and critical for people who practice in this area. And here I am thinking about the conflicts between regulatory reviews of business transactions and antitrust agency reviews. This is not a new problem by any means. We have these conflicts or differences, that play out not only on the federal level. We have Public Service Commissions that do reviews on the state level of mergers, like telephone company mergers or electric utility company mergers.

And, of course, I have to say we do have state antitrust enforcement, and we shouldn't forget that. State antitrust enforcement does add another layer of review, where state enforcers tend to be concerned with the effects of transactions as they particularly impact on local or state markets, even though they may have broader national or international effects; and that goes into the mix on an institutional basis. So we have these conflicts and interactions which we have to play out, and sometimes, at least if it gets turned that way as a legal matter, try to figure out and determine the effect of an agency review under a public interest standard, what that means for subsequent antitrust review and litigation. This is a traditional problem between antitrust and regulation, and one that we still have.

I would like to move from those general things to maybe putting forward a role that I tend to see for antitrust enforcement today. I would view it as "tending the free market," not necessarily competition policy or statutory policy. Antitrust is very important for tending the free market in the merger wave and restructuring wave that we see in all of these industries. These are really extraordinary structural changes, and each of the three industries that were represented on the first panel are subject to that. Certainly health care and telecommunications and electric power, but we could go on and through industries that are now somewhat connected, let's say via Internet technologies. There are tremendous structural changes that are going on, very large mergers, and obviously a great challenge for antitrust analysis is how we think about markets in those cases and how we think about market power.

I'll just remind you now, since I said I was going to relate it to *Microsoft*, of Steve Houck's discussion of market power for the operating system, another network issue, by the way. And I will just mention cases that I see

in our office that are related to the three areas of the first panel.

Starting with health care, a case that's been under litigation involves a competitor collaboration between two hospitals in Poughkeepsie, New York. Now these hospitals, from our point of view, have simply divided the market; decided I'll have this kind of equipment, you have that kind of equipment, we'll price it all together. Isn't this a wonderful view of health care? We won't waste money by competing and investing in these facilities. Now, maybe—I don't want to say yes or no—but *maybe* at some point they really thought that's the way to do it. Maybe we all thought, or at least maybe health care people thought, that was the way health care markets should be organized. But those competitors that stayed as separate hospitals now found the ground shifted under them. The 1996 Act came in, with major structural changes in the way health care gets priced and delivered, and with antitrust scrutiny. As we are tending the free markets, which is, I think, our role and mission, we look and say, we believe in marketplace competition and we see two separate competitors. No more than Ford and GM can decide who is going to build SUVs and who won't, you can't divvy this up. But from the point of view of regulation and deregulation there is a shifting of the ground for industries. Firms that were in one legal environment and were regulated have moved to a less regulated, more free market environment.

There has to be greater consideration of antitrust problems, which all of you, I'm sure, deal with on a day-to-day basis, as we do in our office.

Another example is electric power. Con Edison is merging with Northeast Utilities. How do we think about market power between two companies that are mainly distributors, neither in each other's markets? Perhaps if all these other things that we heard about with the ISOs is working and we have marginal cost pricing delivered to these utilities, where do they get any market power? Or, conversely, if you want to look at it, where do they get any efficiencies? They are not producing and have two networks in two different places. What is the efficiency of putting together a merger? So how do we think about this?

We have a problem in thinking about market power, and we have a problem on the flip side, how do we think about efficiencies, and, are there any? That last point, by the way, was an observation that Fred had made to me on the phone several months ago about this merger, and I think it is a really interesting one to think about. And then we also have, of course, review by the Public Service Commission.

Telecommunications is the final area, and we have three important mergers: AT&T-Media One, MCI-Sprint, AOL-Time Warner, which fit together in some ways actually. The AT&T-MediaOne merger and the AOL-Time Warner merger raised an issue of some particular concern, which is access to broad-band cable, high-speed internet service provided over cable. AOL, major internet service provider, acquires Time Warner with major cable properties in the City and in New York State. How do we think about access? Is it an essential facility, as Fred suggested? How do we think about the need for access? Is there an antitrust solution here? A regulatory solution?

There are major important problems as we move forward in these wonderful new technologies. The main antitrust goal, it seems to me, is to keep them open, to keep competitors there competing, real competitors. MCI-Sprint, do we say, oh, it is wonderful, we know that Bell Atlantic, one day, and eventually, all the RBOCs are entering. Well, okay, Linux has entered the operating system market. Great. Are these niche players? Will they be big, will they be important? Are these firms entering simply as resellers of capacity of the current long-distance providers so they are not adding anything new? These are very complex difficult problems to deal with. But we do have immediate issues. We do have the need to tend the free market and to look for antitrust solutions. We regulators/government policymakers have an awful lot of trouble predicting the future. The institutional mechanism of preference is markets. If we can go for that solution we ought to.

And as I told you, I'd get it back to *Microsoft*. If we go back and look at, how should we deal with Microsoft? Markets, it seems to me, are the answer. Who can predict what's coming next? We want to make sure we have vigorous open markets with a sufficient number of competitors pushing each other.

MS. LEVY: Does anybody have any questions?

SPEAKER IN AUDIENCE: Yes, actually, Professor First moved right into it. I want to ask Mr. Nannes about merger enforcement or what's perceived as a lack thereof in the telecommunications recently. William Safire wrote this editorial a month ago or something that I read about, just focusing on software and *Microsoft* or not on telecommunications, and the convergence factors that Mr. Silverstein talked about were being wrought with fear, are going to be lost because instead of having more competitors and a larger marketplace, have a larger marketplace but fewer competitors because they all bought each other.

MR. NANNES: Well, we were delighted to see that Bill Safire was writing about the need for enforcement. I mean you're certainly right, that it is a set of issues that we are wrestling with every day. Now I wasn't at the Division when the decision was made on Bell Atlantic and NYNEX, so I can't tell you the specifics that went into that particular determination. But that may be one of the kinds of situations where you have to look and see whether, if you went to an exclusively antitrust model based on how the courts have interpreted § 7, that you

would feel as a public policy matter you have the tools to intervene in all the circumstances in which you might think that intervention is appropriate. As Alan indicated, you know there's a body of § 7 law providing that when we go into court we bear the burden. The courts have been reasonably hospitable in horizontal merger cases and perhaps unreasonably inhospitable in potential competition cases. So we have to take the likelihood of success into account before we file a lawsuit.

Now, you have a situation in one of the RBOC mergers where, as Alan recounted it today, the FCC imposed very substantial conditions and requirements as a condition of approving a transaction, and I think it's fair to say that they imposed conditions that we would find it extraordinarily difficult to bring within an antitrust rubric. So I can tell you two things. On the one side, we look very carefully at the RBOC mergers because we are aware of all the issues to which you and others alluded. And secondly, we have to take a look in the context of whether there are benefits of having a second tier of review pursuant to a different standard. It is a matter of complexity.

MS. LEVY: Any other questions? I take it from your last comment that you think regulatory agencies are here to stay, notwithstanding deregulation?

MR. NANNES: Well, it may depend on what happens this fall. I mean there have been some initiatives in Congress within the last six or nine months to substantially contract the FCC's review of mergers by putting them—subjecting them—to a particularly specific time table. There are some FERC commissioners who believe the agency ought to get out of the merger business because otherwise it is a roving commission to impose whatever conditions a majority of the commissioners believe at any given time would be consistent with the public interest. My suspicion would be that if there were a very substantial "pro-business pro-free market, less reliance on government" Congress and White House, you could see some contraction in the scope of regulatory agency review over mergers and acquisitions.

DR. KAHN: Just to be wishy-washy about it, it's my feeling that the FCC's conditions that it imposed on its approval of the SBC-Ameritech merger are outrageous. Who the hell do they think they are? You know, I don't think antitrust is the beginning and end of all wisdom. But there's one thing to correct a merger as antitrust does, to eliminate concentrations that are created by it. It is another to say we'll approve this merger, but you have to open the taxicab stand on this corner, because there isn't competition on it.

MR. FIRST: Can I just interrupt Fred for one second. I think of Time Warner/Turner where the FTC said, "We'll approve this merger if you carry another competing all-news network." So I guess maybe we shouldn't all be holier than the regulatory agencies, although you could make an argument that merger review is somewhat of a regulatory exercise and that this, in fact, is what's concerning Chairman Pitofsky right now and the subject of his remarks at the City Bar some months ago.

Presentation of the Annual Award for Service to the Antitrust Law Section

Given to Professor Eleanor M. Fox

MS. GIFFORD: Hello, everyone and welcome to our annual dinner. Speaking of programs, for those of you who didn't come this afternoon, you should be very sorry because we had three wonderful substantive programs today. Bill Lifland's presentation of the developments of the past year in antitrust, a program moderated by Barry Brett on Harmonizing Intellectual Property and Antitrust, and I actually think the panel almost did it. They almost harmonized intellectual property and antitrust. And maybe we'll try it again next year and finally get there. And then a two-panel panel on deregulation or actually sort of deregulation, as I think we learned this afternoon, and the pitfalls of it.

It was a truly terrific program, and those of us in the Executive Committee are very grateful to the moderators and to the panelists this afternoon for doing such a wonderful job.

I'm Meg Gifford. I'm the newly elected Chair of the Section. I'm from Proskauer Rose LLP, and I would like to introduce the rest of our distinguished dais. Starting on your right, at the far end of the table is Martha Samuelson, President of Analysis Group/Economics, to whom we are very grateful for sponsoring this very nice reception that we have just had. Thank you.

Next to her is Professor Robert Hall. Professor Hall is an academic affiliate of Analysis Group economics and was one of the panelists on our intellectual property program this afternoon.

We've gone out of order, so excuse me. We've moved people around since I wrote this list up. Next to Professor Hall we are delighted to have with us on the dais and to introduce her to many of you and us in the New York antitrust community, Barbara Anthony, who is the fairly new Director of the FTC's Northeastern Regional Office, and we're delighted to have her join us this evening.

Next is Bob Hubbard who is the immediate past Chair as of about 1:00 this afternoon of this Section, and who is responsible for all the great work that the Section has done this year. Bob is an attorney with the New York State Office of the Attorney General Antitrust Bureau. Next to Bob is Ken Logan of Simpson, Thacher & Bartlett, who is also on the Executive Committee of the Section and as of today is the Vice-Chair and thankfully for me takes over the duties of Program Chair for this coming year. We did tell you that, right, that that was part of the job?

Immediately to my left is someone who I assume everybody here knows, Professor Eleanor Fox at NYU Law School, a long-time member and mentor of this Section who will be receiving the service award from the Section tonight.

To my right is the Honorable John Nannes, who was a partner at Skadden Arps for a long time and is now Deputy Assistant Attorney General in the Antitrust Division of the United States Department of Justice. John was another one of our panelists today on the deregulation panel and will be our speaker this evening, and we are delighted to have him with us doing double duty. And we really appreciate it, John.

Next to John is Norma Levy. Norma is of counsel to Davis, Weber & Edwards, on the Executive Committee, a former Chair of this Section and was the moderator of the panel on deregulation this afternoon. And Norma, thank you for that tremendous job.

Next to Norma is Ralph Giordano. Ralph is the chief of the New York Field Office of the Antitrust Division of the U.S. Department of Justice and therefore one of my former bosses. Glad to have you with us again, Ralph. Next to Ralph is Bill Lifland of Cahill, Gordon & Reindel, who gave his traditional and typically wonderful insightful program this afternoon on antitrust developments in the past year. Bill is the first recipient of this Section's service award. And last, but not least, is Barry Brett of Parker, Chapin, Flattau & Klimpl, former Chair of the Section, on the Executive Committee who moderated and put together the absolutely stupendous panel on intellectual property and antitrust earlier today.

That's our dais.

Before dinner is served, I have one delightful job that I have to perform, and that is to present a gift and thanks to our former Chair, Bob Hubbard.

I just want to say that the Antitrust Section has had a terrifically active year this year. We've done a lot of programs; we've had, I think, a reinvigorated Executive Committee. We've embarked on a lot of very important projects, and it is due to Bob who has done an absolutely tremendous job of actually getting us all to do some work. Great work, Bob. Enjoy your retirement.

MS. GIFFORD: We are going to resume our proceeding. I'm going to ask Ken Logan, the Vice-Chair, to present the service award to Eleanor Fox. Ken.

KENNETH LOGAN: It's very much my pleasure to give this year's distinguished service award to Eleanor,

who I think is known to most of the people in this room. I think she's known as a lawyer and practitioner. She's known as a teacher at NYU where she's been on the faculty since 1976 and has the trade regulation Chair. She's known to you as an advisor to a number of governments, including our own, but also to countries—developing countries—that are trying to formulate the very early stages of competition policy, governments like Poland or Bulgaria or Indonesia or South Africa or Croatia, and I'm sure others that I don't remember.

Eleanor is a writer both of antitrust works and for some of us we know she's also a writer of fiction, not shared with many other people. But what makes this a pleasure is to personally take a moment to talk about Eleanor as she relates to me.

I think everybody in this room probably remembers the first day she or he went to work at a law firm or elsewhere, your first assignment, your first memo, the first person you worked for. And for me, going on 28 years ago, my first day at Simpson Thacher was to work with Eleanor and to do all of those things: the first memo, the first deposition, the first real work to analyze an antitrust problem. From then on she really was my first mentor, not just in the area of antitrust, but she taught me what it means to be a mentor in learning how partners and associates should work together.

Eleanor became a partner at Simpson Thacher in 1970. She was the first woman to become a partner at the firm, a fact that I surely did not appreciate at the time at all. And increasingly, I have become aware of just how important that was, not just for Eleanor and for Simpson Thacher, but for everybody. She taught me what it's like to always be a student and always be a teacher. She taught me, as a mentor, that however busy she is, she always has time for a friend. And it's therefore wonderful to have a time and a place and an occasion to say, "Thank you, Eleanor," and then to give Eleanor the service award on behalf of everyone.

PROFESSOR ELEANOR M. FOX: Thank you. That was really wonderful, and I reciprocate the feeling. I had so many wonderful days practicing with Ken. I will take the occasion to reminisce.

I was the Chair of this Section in 1978-79. I can hardly believe that 21 years ago I was on the podium here as the outgoing Chair.

What was happening then? In 1979 the *IBM* case was exactly ten years old. It had been in discovery for six years and in trial for four. It was classically unmanageable, and gave the reputation to big cases as being untriable. A year before, in 1978, President Carter appointed an antitrust review commission, on which I had the pleasure to serve. John Shenefield was the Assistant Attorney General for Antitrust; Mike Pertschuk was the head of the FTC. Fred Kahn, who was here earlier, was the head of the CAB. Senator Metzenbaum was the head of the Senate Antitrust Subcommitte and Senator Hatch was the ranking minority member. All of those individuals were members of the National Commission for the Review of Antitrust Laws and Procedures. In 1979 at time of this annual dinner, I was the outgoing Chair, and we, the Antitrust Review Commission, were just about to come out with our report. We were expecting John Shenefield, who was flying up from Washington, to be our dinner speaker. I had also asked my dear, dear senior partner, Whitney Seymour, to be on the podium and possibly say a few words after John finished his speech.

It was pouring that night. The rain was coming down in bucketsful. John Shenefield didn't appear. When we were almost finished with dinner, we got a note saying that John's plane was still circling in the air and might not land in New York. So at the end of the dinner, Whitney Seymour became our dinner speaker. In his usual wonderful style, he told stories; his personal stories about his friends—the judges of the New York Court of Appeals and Justices of the Supreme Court. Justice Cardozo, Justice Warren, many others. They were all Whitney's friends. Everyone was charmed, delighted and amused, and very, very happy. The next week our Commission's report came out. Two years later administrations changed. Three years later Assistant attorney General Bill Baxter withdrew the *IBM* case because he was afraid he would win; and markets had changed. Time went on. There was barren valley before the next peak of antitrust.

Joel Klein and David Boies have shown that the DOJ can try a big monopoly case, and can do it in much less than 13 years. History repeats itself with a difference, and I have the pleasure of serving on another antitrust study committee. This is the International Competition Policy Advisory Committee to Attorney General Reno and Assistant Attorney General Klein, particularly important in the context of globalization of markets. We expect to present our report in one month. The passage of time also holds happy surprises. I would not, could not have thought, as I stood here 21 years ago, that my son Randy would be a lawyer, that he would be an antitrust lawyer, and that he would be here at our dinner tonight.

I see so many very, very good friends here. I am really pleased and touched to get this award from this wonderful group. Thank you.

Dinner Speaker:

JOHN NANNES, ESQ.

Deputy Assistant Attorney General
Antitrust Division
U.S. Department of Justice
Washington, DC

MR. HUBBARD: I have the pleasure of introducing John Nannes. I'm sure many of you know him. He worked with the Department of Justice before he started at Skadden Arps, and after he worked at Skadden for a while. And he asked me to keep my introduction short and sweet, but nonetheless I do have to pass on an anecdote. I did spend a few of my years at Skadden, and I still remember times that we would be talking about matters, and every so often it would get complicated. We'd have to think. There would be a pause, and people would say, "You should raise that with John Nannes." John's depth of thought and the respect that he enjoys is, I think, very beneficial in the Antitrust Division now. We're very happy to have him speak for us. We hope that you don't perceive this as a bait and switch. We're very happy to have John Nannes with us.

JOHN NANNES, ESQ.: You can say it is not a bait and switch, but I know a bait and switch when I see one and this is a bait and switch. Thank you very much.

It's a personal and a professional pleasure to be with you this evening. It's personal because for 20 years while I was engaged in private practice and before I joined the Antitrust Division two years ago, I had the opportunity to meet and get to know many of you. It's nice to see so many friends again. But it's also a professional pleasure because this is one of the few times during the year that a representative of the Antitrust Division has the opportunity to review and discuss antitrust developments with an audience that includes so many of the lawyers that advise major companies every day about the antitrust consequences of proposed transactions and business behavior.

There is an understandable temptation at times like this to try to place current antitrust enforcement efforts in the context of worldwide economic developments. Much has been written and said, particularly as we approached the year 2000, about the implications of globalization for antitrust enforcement and the success of the American model. This evening, though, I would like to take a very different approach and review with you instead some of the important enforcement initiatives that the Antitrust Division undertook this year and to tell you what we're likely to be doing this year. In so doing, I don't wish to be misunderstood. The "vision thing" is very important. But as clients come to you for antitrust advice about whether they can proceed with a certain transaction or engage in a certain practice, they are probably less interested in knowing where antitrust law is going to be five or ten years from now than they are in where antitrust law is right now. And hence the title of my remarks this evening is "The View From the Antitrust Trenches."

We have three components of our antitrust enforcement program. Our criminal enforcement program has seen dramatic changes in recent years, culminating in record-shattering criminal fines in 1999.

Certainly, as you all know, criminal prosecutions of domestic companies for price fixing, for bid rigging, for market allocation agreements, have long been at the heart of our enforcement program. In the past few years, however, the Antitrust Division has prosecuted and detected a significant number of international price fixing cartels that have directly impacted substantial volumes of U.S. commerce. We found many of these cartels were highly sophisticated, involved leading firms in their industry and affected a wide variety of goods sold to U.S. businesses and consumers. And they are particularly brazen.

I suspect that not many of you have had the opportunity to observe an unlawful price fixing conspiracy in action, but in the recent ADM trial, the Antitrust Division played for the jury audio and videotape excerpts of actual price fixing meetings. On one occasion the conspirators, who had come to attend customer trade association meetings, arranged to meet privately in a hotel room. To avoid arousing suspicions among their customers, who were also staying at the hotel, they decided to stagger their arrival at the meeting room. In one tape, some of the conspirators are shown awaiting the arrival of the others when there was a knock at the door. One of the foreign competitors quips "FTC?" and the others laugh. Actually it was not the FTC. It was an FBI agent working for the Antitrust Division, dressed as a bellhop, to deliver a briefcase with a hidden recording device.

On another occasion a senior executive in a U.S. company shares his company's credo with a foreign competitor and, I quote: "We have a saying here in this company that penetrates the whole company. It is a saying that our competitors are our friends, our customers are the enemy." This knowing and callous disregard of the antitrust laws is certainly unmistakable.

In fiscal 1999, the Division collected over $1.1 billion in criminal fines, the vast majority of it attributable to these international price fixing cartels. Let me put this in a little bit of a historical perspective. Prior to 1997, the highest amount of fines collected in a year was $42 mil-

lion. The year after that it jumped to $205 million and then to $265 million. And if you combine the last two years with fiscal 1999, the fines are many multiples of the fines collected in the entire history of the Sherman Act since 1890.

We've also been successful in negotiating plea agreements and obtaining litigated convictions that resulted in imposition of substantial jail sentences for business executives found to have violated the antitrust laws, including foreign citizens who had never come to the United States to conduct conspiratorial business. These recent successes are destined to have a substantial impact on criminal enforcement efforts this year and in years to come.

The Division has undertaken a number of initiatives, including the corporate amnesty program and the preadjudication protocol with the Immigration & Naturalization Service, that are all designed to encourage firms and individuals to report illegal cartel behavior. At the present time, there are 30 grand juries looking into international cartels, and antitrust enforcement agencies around the world are developing their own criminal enforcement programs, often patterned after the American experience. Indeed, last fall, the Division hosted a two-day program for representatives of more than two dozen countries to discuss criminal enforcement techniques.

There certainly was a time when companies thought that they could evade the constraints imposed by our antitrust laws simply by holding their conspiratorial meetings outside the United States. Our criminal enforcement efforts have given new meaning to the phrase: "You can run but you can't hide." To be sure, it may not become an annual event to obtain a criminal fine from one company of $500 million, as we did last year from F. Hoffman LaRoche, or even $225 million as we did for one company last year, BASFAG. But even if those fines are excluded, criminal fines over the last two years have averaged well over $200 million. Our goal is simple. We want to make sure every person around the world who contemplates price fixing that could impact U.S. businesses and consumers will choose to forego such illegal activity because they reasonably fear they are going to be caught and they are going to be prosecuted.

On the merger front, the continued success of the American economy in recent years has been mirrored by an unprecedented level of merger and acquisition activity. Hart-Scott filings, which had remained roughly constant around 1,400 a year for the first three years of the decade, reached 2,800 in fiscal 1996 and then jumped 600 the following fiscal year and then ballooned by over 1,000 in fiscal year 1998, to top 4,500. Those who thought this increase was going to be short-lived were proven wrong when filings remained at that high level last year. And indeed, for the first three months of this year we are up over 14% on a year-to-year basis.

Numbers, of course, don't tell the story. There can certainly be an increase in filings without there necessarily being a corresponding increase in competitively problematic transactions, as we saw for example in the LBO wave of the late 1980s. However, mergers and acquisitions that we are seeing these days are quite different. Companies are making strategic decisions to exit markets that they cannot dominate, often selling out to firms that think they can. Buyers are trying to position themselves for the global economy, often equating size with success. With breathtaking technological developments occurring every day, we see firms anxious to realize first mover advantages in network industries or to take out nascent entrants that threaten their long-term dominance. In such dynamic industries, the task of distinguishing between procompetitive and anticompetitive transactions has never been more important.

Last year we challenged 46 transactions, which were the same as the year before, but those two years were significant increases over prior years. While most of the cases were resolved by consent decrees, we have not been hesitant in seeking to block transactions in their entirety. Both the Lockheed-Northrup transaction and the Primestar transaction were abandoned last year after we filed complaints and were well into discovery. And parties have abandoned other transactions, such as Monsanto-Delta and PineLand after learning of our intention to sue.

Those of you who counsel clients about mergers and acquisitions presumably took note of the fact that the Antitrust Division brought two cases last year predicated in whole or in part on monopsony concerns. In *Cargill-Continental*, we found that the geographic market for inputs was narrower than the geographic market for outputs. We concluded that the combining firms would have been able to depress the price for inputs even though we did not have a concern that they would have the ability to raise the price of outputs. Allegations were also made in the Aetna-Prudential complaint.

On a going-forward basis, there are two areas of some concern to us that may be of interest to you. First, we have seen a number of transactions involving such products as computer software in which it appears that a dominant company has sought to acquire a recent entrant because of the concern that the recent entrant would otherwise evolve into a substantial threat if it remained independent. Often, we find the dominant firm actually has plans to discontinue the product offerings of the firm that it is acquiring. These kinds of transactions pose some interesting doctrinal issues because the recent entrant is unlikely to have a substantial market share at the time of the proposed acquisition. Yet, we will challenge such a transaction if we conclude that the elimination of the recent entrant is likely to lessen competition substantially. We had anticipated that our *Compuware-Viasoft* case would present this issue with respect to one particular product market, but the parties abandoned the transaction last week.

Second, we are seeing an increasing number of partial acquisitions, often in industries in which minority investments create a complex web of interrelated relationships. Traditionally, small minority equity purchases have not received much attention from antitrust enforcement agencies. That's likely to change for two reasons. First, unlike purely passive minority equity investments, minority investments these days are often far more intricate. They may carry the right to representation on the board. They may confer supermajority or other special voting rights, or they may permit the exercise of influence over management, all of which are inconsistent with notions of a purely passive investment. Second, there are certain industries in which the so-called minority investments are not isolated occurrences but rather a pattern of dealing. In both types of situations, questions can reasonably be asked about the likelihood that the firms involved will compete as vigorously against one another, either in markets they presently serve or markets in which they are potential competitors, as they would have absent these investments. Some of these issues are likely to be addressed at our *Northwest-Continental* case, which challenges Northwest's acquisition of a class of Continental common stock that gives Northwest more than 50% of the voting interest in Continental although only 14% of the financial interest. That case will go to trial in the fall.

Thus, it's not only the number of Hart-Scott filings but also the complexity of transactions that combine to make this a challenging time for the antitrust enforcement agencies. It is ironic in my view that some people have chosen this time to reexamine the second request process and to consider imposing substantial restrictions that can only inhibit our ability to conduct timely and complete merger investigations. We issue second requests only when we have significant competitive concerns about the transaction. It might surprise you to know, for example, that while Hart-Scott filings are up big time over fiscal 1997, the number of second requests issued by the Division and the FTC is actually down. Last year, for example, we only issued second requests in less than 1.5% of the transactions for which we received filing. Even so, we are aware of complaints. Second requests can be burdensome in particular situations, and we are on the lookout for ways to make the process work better. But make no mistake about it, the Hart-Scott process is absolutely essential if mergers and acquisitions are to be reviewed in a way that gives the antitrust enforcement agencies a reasonable opportunity to halt transactions that pose a significant threat to competition.

The third primary component our antitrust enforcement program involves civil non-merger matters. In the not-too-distant past, this was a relatively low priority due both to competing resource needs in the Division and the nature of those matters. Civil non-merger matters often don't have the same time constraints as apply, for example, to a merger subject to Hart-Scott timetables. And, at the same time, some of the civil non-merger matters have involved issues of substantial complexity that have necessitated thorough, though time-consuming, analyses.

Whatever may have been the circumstances in the past, however, this paradigm no longer holds true for civil non-merger efforts. In the first place, several of our most important competitive developments affecting our economy are occurring in markets characterized by rapid technological change. In addition, there are developments in network industries that have far-reaching competitive implications even if the industries are not characterized by rapid technological change. Sometimes these activities involve collaborations between and among competitors; other times they involve a single dominant firm. In either case, the message to antitrust enforcers is clear: it is important to make enforcement decisions quickly, and it is important to make those decisions correctly.

Any description of our civil non-merger enforcement program during the past year must begin with the *Microsoft* case, brought in May 1998. Witness examination was completed in 1999. Judge Jackson issued his findings in November. The parties are completing their submissions of proposed conclusions of law, and oral argument is scheduled for February 22nd.

The *Microsoft* case has so dominated the popular trade press that sight may have been lost of two other significant non-merger cases filed in 1999. In May, the Division sued American Airlines, charging unlawful monopolization and attempted monopolization in American's hub in Dallas/Fort Worth. The complaint alleges that American engaged in a variety of predatory practices, including price reductions and additions of capacity, that were intend to drive startup carriers out of Dallas/Fort Worth. This is the first predation case brought against an airline by the Antitrust Division since the industry was deregulated in 1979. It is, and deserves to be, a very closely watched case, not only for the airline industry, but for other network industries as well.

Earlier in January 1999, about a year ago, the Division also filed a case against Dentsply International challenging distribution practices in which Dentsply had signed up under exclusive arrangements distributors representing 80% of the sales of the nation's false teeth, depriving its rivals of effective distribution networks. Both American Airlines and Dentsply will go to trial in the year 2000.

What is notable about these three cases—*Microsoft, American Airlines* and *Dentsply*—is that all of them are single firm cases. If anything surprised me in coming from private practice to the Antitrust Division, it is the amount of resources that is going into analyses of single firm behavior. For a significant number of years, the Antitrust Division brought virtually no § 2 cases. Now it has brought three in the past two years. Firms with significant market power would do well to revisit § 2 standards and to follow developments in these cases.

What does the year in front of us have in store? When Joel Klein became Assistant Attorney General, he was fond of saying that the Antitrust Division had been out of the litigation business too long, reflecting that most of our cases were resolved by consent decree. Perhaps he should have remembered the old proverb that warns, "Be careful what you wish for." The Antitrust Division faces a daunting trial schedule in 2000. In addition to further *Microsoft* proceedings, *American Airlines*, and *Dentsply*, we will be litigating two § 1 cases, one challenging practices and the structure of Visa and MasterCard and the other challenging certain boycott activities in Delaware by the Federation of Physicians and Dentists. We'll also be trying the *Northwest-Continental* case. And, of course, there may be others on both the criminal and civil side of the shop. No one presently in the Antitrust Division can remember a time when there was more ongoing high-profile antitrust litigation.

We spend a good deal of time worrying about resource allocation. The Division has just weathered a difficult attack on its budget; nevertheless we do remain severely constrained. We currently employ 361 lawyers, which interestingly is about 100 lawyers less than the Division was employing 20 years ago today. Our budget for fiscal year 2000 is $110 million; that's an increase over our 1999 expenditures, but after nondiscretionary cost increases and anticipated costs of litigation are taken into account, that increase will permit us to add two lawyers and a handful of paralegals to handle a workload that is increasing on every front.

In the year ahead, we will also be trying to get a handle on a problem that seems to be arising more often. We are troubled by the number of instances in which the Antitrust Division has been provided with information that turns out not to be true. On a number of occasions over the past few years, attorneys have provided the Division with materially erroneous representations. It is often difficult from our vantage point to know whether the attorney has knowingly done so. Sometimes the responsibility seems to rest with the attorney and sometimes with the client. But whatever the source, these misrepresentations frequently involved important matters going, not only to facts relevant to the potential violations being investigated, but even to the nature of relief proposed by the private parties themselves to resolve our antitrust concerns. We have also seen instances in which companies have sought to walk away from commitments made in consent decree negotiations and even knowingly and deliberately to violate the terms of consent decrees. If they had hoped that the press of other business would cause us to give them a free pass on such conduct, they were badly mistaken.

People with more lengthy experience at the Antitrust Division than I report that the frequency and nature of such behavior seems to be growing. You should know that we take this matter very seriously, and we urge the Bar to do so as well. As those of you who practice regularly before the Antitrust Division know, the currency in which an effective attorney trades is his or her personal credibility. If we have reason to believe that an attorney's representations are accurate, this can often streamline second request modifications, reduce the need to interview business people, expedite consent decree negotiations, and ultimately improve an attorney's ability to get the job done. Unfortunately, the converse is true. When counsel lacks credibility because of knowingly false—or even carelessly false—representations, this will inevitably slow an investigation. We may have to insist on further production and more interviews in order to assess the competitive situation and more specific and readily enforcible undertakings in order to assure that relief will be effective.

These same principles apply to what we characterize around the Division as repeat players, companies that appear regularly before the Antitrust Division, particularly with respect to proposed mergers and acquisitions. If a company fulfills its obligations under a consent decree by promptly divesting assets to a suitable purchaser, that affects the manner in which the Antitrust Division can deal with the company when the company wants it do its next deal. If, however, a company fails to perform its obligations and seeks to frustrate agreed upon relief, it can expect that the next time around the Antitrust Division will seek greater safeguards to assure effective relief. We may seek a shortened time for divestiture, or the immediate appointment of a trustee, or even insist on a fix-it-first solution before the company can proceed with a core transaction even if the assets to be divested are a relatively minor part of the acquired entity.

We urge you to convey to your clients the importance of both personal and institutional credibility. Sometimes these days, when we confront attorneys with evidence of misrepresentations, they figuratively "shrug their shoulders" as if to to say the fault rests with the client. That doesn't do it for us. We expect that attorneys will not make representations to the Division unless they have taken the steps necessary to ensure that those representations are true. That is the way to be an effective advocate for your client at the Antitrust Division.

So let me thank you again for letting me share with you this perspective from the trenches. There seems to be no doubt that 1999 was a year of substantial and important antitrust enforcement developments. And whatever else may be said about the year 2000, there is no reason to think it will be any different.

MS. GIFFORD: Thank you, John, for those instructive remarks. I think the room was quieter than I've ever heard it, particularly at the very end. And thanks to all of you for coming to our dinner.