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Inside

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of the New York State Bar Association

Message from the Chair

To the Members of the Corporate Counsel Section:

As Chairperson of the Section, I would like to share with you some of the recent activities which the Section has been engaged in, as well as some upcoming events and other points of Section interest.

At the Annual Meeting in January, the Section co-sponsored a program with the International Law and Practice Section, entitled "The Impact on International Commerce of the Patriot Act, Sarbanes-Oxley and Other Recent U.S. Laws." Expert attorneys from both Canada and the United States participated in panels on several very timely topics, and attendees received 3.5 CLE credits for the program.

Recently, the Section completed an extensive survey of its membership, which will serve as a jumping-off point for our development in the years ahead. As we strive to understand how we can best serve our members, the Section's Executive Committee will focus on opportunities for Section growth in ways which reflect the wonderfully diverse community of in-house counsel which exists in New York State. As in-house counsel, we are not only leaders in the legal community, but we are also leaders in our companies, and there is so much we can do in those roles.

After reviewing the results of the membership survey, the Section's Executive Committee culled out two basic themes. The first was the membership's desire for more program opportunities outside of the New York City vicinity. To address this, our first CLE program of the year will be held upstate, in Saratoga County. This program is co-sponsored with the Commercial and Federal Litigation Section and will be held May 13th through 15th, at the Gideon Putnam Hotel, in Saratoga Springs, New York. The weekend session will examine the jury in the context of commercial cases and will also provide an opportunity for meeting colleagues from across the state.

Our second CLE program, which will be held September 22nd and 23rd, is the first NYSBA "Corporate Counsel Institute." A day and a half of CLE programs, with break-out sessions, specifically geared to the interests and concerns of in-house counsel will take place at the Princeton Club in New York City. Hotel rooms in the area will be made available at a discount for attendees. We are excited about both programs and ask that you visit the Section's website at http://www.nysba.org/corporate to view updates on the programs. I hope to see you at these Section programs.

The second theme derived from the survey is the membership's desire for more opportunities to become involved in Section activities. To address this need, the Section's Executive Committee has re-established the standing committee format. We chose to set up six com-

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mittees, which will be very useful to the membership of the Section going forward. Those six are CLE Programs and Annual Meeting, Corporate Governance, INSIDE, Internship, Membership and Pro Bono. The committees are chaired by three past Section Chairs and three current Section Officers. What we need now are members to get involved in Committees of their choice. Committee membership and involvement can be your give back to the Association and the profession, as well as an opportunity to network with other attorneys with similar interests and lay the groundwork for possible leadership positions in our Section and the Association.

We need your ideas, your talents and a little bit of your time. We need the enthusiasm of our younger members, the drive and ambition of those in mid-career and the experiences and depth of knowledge of our more senior members. The time commitment is not great and most Committee meetings can be attended by telephone conference. Should you wish to learn more about any of the Section's Committees, please contact the Committee Chairs listed below.

CLE Programs and Annual Meeting—Steven Nachimson; 914-935-5375; steven.nachimson@compass-usa.com

Corporate Governance—Iskah Cavell Singh; 201-894-2754; iskahsingh@unilever.com

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Membership—Tom Reed; 212-722-3610; thomas.reed@verizon.net

Pro Bono—Steven H. Mosenson; 212-356-1224; steven.mosenson@nyu.edu

I would like to draw your attention to the issue of pro bono and its application, both actual and potential, in the corporate law department setting. Corporate counsel are in a unique position to promote the expansion of the traditional concept of pro bono to encompass other ways of giving, such as providing financial and material support for non-profit legal service groups, and volunteering as a law department to provide a service that is not legal in nature. If you would like to consider donating your time to doing pro bono work for a not-for-profit corporation, you may be interested in knowing that there is CLE credit available for volunteers. To learn more about how you can participate in such programs while earning CLE credit, please refer to Vol. 21, No. 2 of *Inside*, the newsletter of the Corporate Counsel Section, which is available electronically to members of the Section through the website.

This current ISSUE of *Inside* reflects the many areas of our members' interests. Included are three excellent articles, on three different practice areas, all of interest in some way to in-house generalists. The topics range from the reasons why hourly billing continues, to liability issues for "sharing" with other employees in your organization copies of copyrighted material and a discussion of the refusal to deal concept in antitrust law, in light of last year's Supreme Court ruling.

I hope you enjoy this issue of *Inside*, and that through it, you become more involved in the activities of the Corporate Counsel Section. On behalf of the Executive Committee and officers of the Section, we encourage your interest, and welcome your participation in the activities of the Section and look forward to meeting you at upcoming Section-sponsored events.

Mitchell F. Borger

Why Hourly Billing Survives

By Rees Morrison

Most law firms bill ninety percent of their time on the basis of the hours worked by lawyers and paralegals multiplied by their standard billing rates, despite virulent criticism of hourly billing over the past two decades. If, as critics harangue, the system breeds many problems, then there must be equally powerful forces supporting the status quo. Those reasons are economic, psychological, and organizational.

The Method is Simple

Law firms find it very simple to multiply hours worked by a billing rate; law departments find it simple to understand such bills. Alternative methods of billing inevitably introduce more complexity.

Comfortable Standard Completely Familiar to All Sides

Everyone knows the system. A generation of partners does not know of any other way to bill, such as the "services rendered" bills of the sixties and before.

Applies When No One Can or Wants to Calculate Value of a Service

Hourly billing bypasses the difficulty of determining ahead of time the value of a particular legal service. If a law firm obtains a permit for disposal of effluent, can the company state that the permit was worth $21,000? If a law firm labors mightily on an acquisition that falls through, what can be the value other than the hours worked?

For law firms, the value of the same amount and quality of legal work to one client could be completely different than the value of the same work to a second client. Yet, it simplifies life to stay with the common denominator—hours worked. An hour is an hour is an hour, as Gertrude Stein did not say. Yet, no one cares how many hours it took General Motors to build a car; no one asks how many hours it took to complete a movie.

Because most clients appreciate that legal work of any significance cannot be standardized, hourly billing prevails. Unlike changing a car's oil, mowing a lawn, or installing 500 square feet of hardwood flooring, much work of lawyers cannot be predefined with any precision. Because clients find it so hard to assess the value of work or the effort to be expended, they fall back on the comfortable alternative.

Part of the enduring prevalence of hourly billing comes about because consumers of legal services purchase them in a highly fragmented market. If much more knowledge were available about how a service is provided, and the likely cost range, such as is true with eye exams, root canals or architectural plans for home improvement, we would see a reduction in information asymmetry. The online bidding services are a step in this direction as are competitive bids for fixed-fee work. (Over time, this argument for hourly billing will weaken. Groups of law departments may share data and thereby develop a better understanding of what a plain vanilla service costs. Vendors, especially those who offer case management software that tracks outside counsel spending, may try to aggregate such data. Surveys by consultants and trade groups could feed this growing body of shared knowledge and prices.)

> *"Law firms naturally cling to a system that minimizes their responsibility for efficiency and maximizes their ability to earn money."*

Lets Law Firms Make More Money

Hourly billing allows, indeed encourages, profligate work habits. Cost-plus billing, where every hour recorded can be an hour of pay or recognition can degenerate into disregard for market discipline. So too the obvious benefit of being paid for working more hours can lead overtly or covertly to inflating the number of hours worked. Cost plus can also override scruples about quarter-hour billing increments, which are never marked down, only up. Law firms naturally cling to a system that minimizes their responsibility for efficiency and maximizes their ability to earn money.

In conjunction with hourly billing, law firms have fostered the notions of "produce error-free work" and "leave no stone unturned." Law firms can also hide behind the risk of malpractice: "If we don't research everything, we might be held liable." Law departments can relieve them of some of these worries.

Alleviates Tension-Causing Intervention by Inside Counsel

Many lawyers in law departments, to put it bluntly, not only have no reason to question hourly bills, but, in fact, have sound personal reasons for continuing the arrangement. Outside counsel relieve pressure on inside lawyers. That pressure can be the pressure of knowing the law, delivering the bad news, making a tough call, slaving over the weekend, traveling extensively, or simply shouldering the load. Why would a mid-level law department lawyer want to bite the hand that serves her? True, calls for cost control may come from the top of the company and pressure the general counsel, but it is hard to translate cost-control goals into actions that personally benefit the lawyer in the trenches. For those on the firing line, it is most convenient if law departments do not require budgeting or estimating value, but only look at hours worked.

Most people are adverse to confrontation. They do not want to ask difficult questions about the value of work done nor answer them. A statement that "we worked six hours on this" is harder to challenge than "this was worth $1,500 to you." The latter conveys a paternalistic attitude of superiority also. Neither side would like to give the other unilateral responsibility for determining the value of a service.

Law departments are as much at fault as law firms for perpetuating hourly billing. Law department lawyers do not need to think hard about the economics of an assignment or the value of its results if they only look at hours clocked. Bills submitted on an hourly basis allow in-house counsel the equivalent of the line item veto. They can focus on the small end of the telescope and question the hours spent at a deposition, rather than thinking about the larger contribution to their company of the law firm's services.

Minimizes Transaction Costs for Both Sides in Engagements

Transaction costs increase when clients and law firms deviate from hourly billing. The most efficient basis for an assignment is for the law firm to record its time and bill it; much less efficient is an arrangement whereby both parties must agree in advance on any method other than hourly billing. Thus, transaction costs diminish at the start of a matter when the law firm begins clocking hours and also at the end of a matter, when the bill can be easily reviewed.

To be sure, someone in the company who retains the law firm can estimate a value for the firm's prospective work, but that foray into the unknown (a) takes time and effort on both sides, (b) requires agreement, (c) and opens up the estimators on both sides to later criticism. Who will look back and say that $25,000 was the value to the company of filing the application before FERC? When a company retains a firm, if someone has to scratch her head to come up with the value of the work to be done, it takes effort and time. Both the company and the law firm must agree to the value of the work.

Hourly billing removes accountability from both the purchaser and the seller of legal service for assessing value "It is what it is, sorry." Other methods of valuing services require someone to make judgments.

Increases Management Tools Within Law Firms and Departments

- Tracking and billing time by hours aids lawyers in running their businesses. Partners in law firms can give assignments with more precision and clarity when they can suggest to an associate how many hours a task should take. If a partner says, "Why don't you research this for five or six hours and let me know what you get?" they give more guidance as to the work effort and investment than if they said, "Work on this until you reach a value of $1,200 to the client."

- It is easier to write-off hours than value. The partner can think, "This should have taken the associate only eight hours to complete, not twelve, so I'll write-off the extra four." If the partner has to say that this should have been only $3,000 of value, it becomes harder to decide the amount and explain the write-off of the extra dollars.

- It is easier to show the billable hours of an associate than the value delivered.

- When law firms plan for hiring, they can think in terms of full-time-equivalent lawyers, which is a rephrasing of hours.

- When law firms increase the hourly billing rate across the board for each class year, it protects the partners from making decisions about relative abilities and improvements of the associates. This decision automatically boosts income if all other factors stay the same. Law firms would have a much harder time arguing that every year the value of what they have done for their clients has increased.

- Hours billed are under the control of associates and partners; collections from clients if something other than known controls depends on the payment policies of clients.

- Hours tracked permit the calculation of many more metrics. If a law firm works only on fees collected, it cannot calculate realization rates, blended billing rates, hours per associate, or set minimum standards of performance ("Thou shalt bill 2,100 hours."). Hours worked provides a *lingua franca* in the legal marketplace.

- The system perpetuates the lack of emphasis on project management in law firms.

- The hours logged by a lawyer becomes a proxy for quality of work and competence of the lawyer.

Law firms accept the Darwinian notion that assignments flow to the more capable associates or partners, so the busy lawyers—those with 2,000 or more hours—must be the better lawyers.

- Hourly billing commodifies lawyers' work. Hours are fungible and those who produce an hour of work are more likely to be seen as interchangeable.

No one would quarrel with using hours as one aspect of setting prices for legal services. After all, the ABA guidelines for ethical billing expressly permit that. Doing so, however, raises the question of whether law firms should establish different billing rates for the same lawyer for different tasks.

Works Regardless of Volume or Type of Services

Whatever the legal service, and howsoever much there is of it, hourly billing can apply. By contrast, alternatives to hourly billing generally flourish only where there is a sufficient volume of work coming from a law department. A small company, without any lawyers inside, tends to know even less about the value of a service or what is involved in this service. What these companies can understand is that an amount of labor went into producing the document submitted or advice given. Where legal work is sporadic, it is more difficult to assess the value of that legal work.

Law firms, conservative creatures, welcome the risk adverse arrangement of hourly billing. They take on fixed-fee work if the volume is large enough, but for episodic work, they fret that the risk of loss is higher than the opportunity for gain. People making decisions are usually adverse to risk. Smaller law firms have even fewer resources to absorb variable risk than do larger law firms.

Fits with Lawyers' Risk Aversion

Clients of internal law departments and the law departments themselves, if they pay a law firm on some basis other than hourly rates, may fear the risk of paying a windfall more than they fear the possible extravagance of hourly billing. Most law departments charge the greater portion of outside counsel costs through to the business or staff unit that incurred the costs. At the very least, in-house counsel can say "the law firm worked all those thousands of hours" and it takes an astute critic to challenge where those hours perhaps were wastefully recorded. On the other side of the bill, law firms see the glass half empty if they evaluate sipping from alternative billing methods.

One could argue that those who work on an hourly basis will be more creative and diligent in finding what they should do on behalf of their client. Those who work on a fixed fee may seek to reach the end result as economically as possible, possibly at the loss of innovation and effort. Some departments worry whether the law firm will shirk when its budget runs out.

Allows Law Departments to Bask in Their Costs-Per-Hour Comparison

Law departments often compare their internal costs of operation, expressed as a fully loaded cost per lawyer hour, to the blended rate of outside counsel. It is a simple matter to divide the budget of a law department—excluding outside counsel fees and patent maintenance fees—by the number of hours that the department's lawyers performed chargeable work. The inside cost per lawyer hour ranges from $120 to $195 an hour. By contrast, the bills of outside counsel, divided by the number of hours logged by lawyers on the bills, comes in much higher, on the order of $245 to $300 an hour with large law firms. This comparison heartens law departments.

"One could argue that those who work on an hourly basis will be more creative and diligent in finding what they should do on behalf of their client."

* * * * *

Hourly billing survives, indeed reigns supreme. Its prominence has withstood much criticism and waves of management initiatives, such as bill auditing, task-based billing, LEDES, ABC, TQM, partnering, and knowledge management, all of which failed to change this deep-seated style.

The hegemony of hourly billing rests on interlocking and reinforcing pressures: simplicity, familiarity, profitability, efficiency, and amiability. Of these forces, we suspect that simplicity and profitability are most prominent. Next in priority are psychological issues of amiability and efficiency. These have led to the ubiquity and longevity of hourly billing.

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Why the Corporate "Policy" is No Shield to Multi-Million Dollar Copyright Liability

By Joseph M. Beck

Most business executives, if asked, would disapprove of copyright infringement; some might add that they have a "policy" warning employees not to infringe. But a policy may not be enough according to a recent decision affirming almost $20 million in damages against a company whose employees faxed, downloaded and forwarded online issues of a copyrighted newsletter to which the company subscribed.

I. The Problem

Contrary to the common assumption that "if it's on the Internet, it's public domain," much material on the worldwide web is copyrighted. (Since March 1, 1989, it has been unnecessary to include a copyright notice on a work; and even items that once were in the public domain may be protected if they are part of an original compilation or have been revised.) While some copyright owners freely grant permission to download or forward materials, many licenses severely restrict any such use. Permission to download may not include permission to photocopy; authorization to use within a corporation's headquarters may not include permission to forward to branch offices, much less to customers.

Another common assumption—that a company can rely on the "fair use" doctrine when copying and distributing periodicals for which it has a subscription—also is questionable. References in the Copyright Act (17 U.S.C. 107) to possible "fair use" for teaching, scholarship, comment and research will not reliably provide a safe harbor for commercial users—even if the use is characterized as for education or research.

II. The Potential Legal Exposure

A. Liability. Copyright protection vests automatically in the author of an "original" work (the "originality" standard is quite low) fixed in a tangible medium of expression (e.g., print, software, video, etc.). Infringement can be proved simply by demonstrating "ownership" (a prima facia case is made by offering in evidence a Certificate of Registration of the claim of copyright) and "copying" (an unauthorized electronic transmission of a protected work from one computer's memory to another's generally creates an infringing "copy"). Moreover, as discussed below, defenses such as estoppel, implied license and fair use may not shield an employer, even an employer that instructs its employees never to infringe copyrights. In other words, liability for copyright infringement is often easy to prove.

B. Damages. The Copyright Act provides for recovery of three kinds of damages at the election of the plaintiff—actual damages (e.g., lost licensing revenue); profits attributable to the infringement; or statutory damages (from $750 to $150,000 for each infringed work). Because each infringed work constitutes a separate offense for statutory damages purposes, liability can skyrocket, e.g., where daily or weekly newsletters are infringed.

That's just what happened in *Lowry's Reports, Inc. v. Legg Mason, Inc.*, 271 F.Supp.2d 737 (U.S.D.C. MD 2003) ("*Legg Mason* 1") and 302 F.Supp.2d 455 (U.S.D.C. MD 2004) ("*Legg Mason* 2"). In *Legg Mason* 1, the Court granted summary judgment as to liability for copyright infringement where a financial services firm, which subscribed to the plaintiff's stock market newsletter, faxed and e-mailed copies to branch offices and the brokerage's research department. The following holdings by the Court deserve attention.

1. Vicarious liability of the employer. The Court rejected the defense that because the copying contravened several memoranda from the defendant's legal and compliance department warning employees not to infringe copyright, the employer could not be liable for vicarious infringement. Noting that "*liability* takes no cognizance of a defendant's knowledge or intent" (emphasis original), the Court added, "The fact that [defendant's] employees infringed [plaintiff's] copyrights in contravention of policy or order bears not on [defendant's] liability, but rather on the amount of statutory and punitive damages and the award of attorney's fees."

2. Equitable estoppel. To establish an estoppel defense, defendant Legg Mason had to show, among other things, that plaintiff Lowry's, through misrepresentation or concealment, induced Legg Mason reasonably to believe that Lowry's did not intend to enforce its rights. The Court rejected this defense because the plaintiff included a copyright notice on its works, finding that "the mere affixation of the copyright notice on copies of the work if seen by the Defendant speaks loudly and clearly enough to counter an estoppel. . . ."

3. Fair use. The defendant did not even argue that its posting and downloading of copies within its office

intranet constituted fair use, and as the Court observed "Nor would such an argument prevail." Rather, the defendant contended that limited copying by paper and e-mail within its research department was defensible as fair use. The Court, however, summarily rejected the defense, holding that the first, third and fourth factors under 17 U.S.C. 107 weighed "heavily" against the defendant. "To the extent that the [defendant's] six or more [unauthorized] copies represented additional potential subscriptions, the copying within the research department diminished [plaintiff's] market."

4. Implied license. The Court easily rejected the implied license defense because "No rational fact finder could conclude" that plaintiff and defendant mutually assented to the defendant's copying.

5. Disgorgement of profits. As mentioned above, a plaintiff can elect to recover, rather than actual or statutory damages, a defendant's profits attributable to an infringement. Significantly, a plaintiff need only show a defendant's gross revenue; it then falls to the defendant to prove the allowability of each and every deduction and the elements of profit attributable to factors other than the copyrighted work. Although the Court declined to award a share of Legg Mason's revenue of more than $4 billion, it appears that the Court might have reached a different conclusion had the plaintiff's expert, on deposition, not admitted that "he could not say whether a causal link connected the infringement to [defendant's] profits." On the other hand, the Court concluded "although it **seems** that some of [defendant's] profits 'should' relate to its infringing use . . . the appearance defies reason. The complex, variable, independent thought processes of hundreds of individual brokers intervene between the copying and any subsequent gain" (emphasis original).

6. Statutory damages. Noting that the Copyright Act authorizes statutory damages of up to $150,000 for each willfully infringed work (*i.e.* for each daily and weekly newsletter), the Court held that the issue of "willfulness" was best "left to the jury."

In early 2004, following a jury trial on the issue of "willfulness" in *Legg Mason* 2, the Court upheld a jury verdict of $19.7 million. Legg Mason argued that only $59,000 of actual harm was shown, and that accordingly, the verdict was so disproportionate as to violate due process. The Court rejected the argument, noting that substantial deference must be accorded to Congress in exercising its constitutional authority to protect copyrights; and that in 1999, Congress amended the Copyright Act by increasing statutory damages "in order to provide 'more stringent deterrence to copyright violations including those involving computer uses and Internet activity.'" Observing that Legg Mason's maximum liability for willful infringement was 36 million dollars, the Court concluded:

> "The jury was not required to believe Legg Mason's assertions that the repeated infringement was due to its oversights and set its damages award accordingly. Further, the evidence indicated that Legg Mason was a sophisticated entity that repeatedly infringed Lowry's copyrights, even when asked to stop. In light of this evidence, the Court will not modify the jury's award or order a new trial because of its size."

III. So What's An Employer to Do?

The answer will depend upon an employer's research needs and market strategies—upon how and how much it uses newsletters, magazines and other copyrighted works. Before preparing a copyright compliance policy, therefore, corporate counsel, with the assistance of personnel from information technology and the corporate library, should identify what kinds of uses are being made of what kinds of copyrighted works. The policy that evolves can then be tailored to a company's needs. For example, a company that relies primarily on a relative handful of scientific journals may want to pursue licenses with the authors covering the uses needed. Of course, the terms of the licenses will need to be explained to employees, coupled with a reminder that the company does not countenance use in violation of the licenses nor other infringement, and that violators will be disciplined.

Companies that rely on newsletters and other limited circulation works may be particularly vulnerable to infringement claims, and, therefore, particularly in need of an effective compliance policy. As noted in the House Report accompanying the revision to the 1976 Copyright Act:

> "It is argued that newsletters are particularly vulnerable to mass photocopying, and that most newsletters have fairly modest circulations. Whether the copying of portions of a newsletter is an act of infringement or a fair use will necessarily turn on the facts of the individual case. However, as a general principle, it seems clear that the scope of the fair use doctrine should be considerably narrower in the case of newsletters than in that of either mass circulation periodicals or scientific journals. The commercial nature of the user is a significant

> factor in such cases: copying by a profit making user of even a small portion of a newsletter may have a significant impact on the commercial market for the work."

What was true in 1976 for newsletter photocopying could prove to be all the more true today, given the widespread opportunity for infringing use of works on the Internet. Indeed, some of this language from the 1976 House Report was cited by the Court in *Legg Mason* 1 in the course of denying the fair use defense for online infringement of a newsletter.

Many companies rely upon a wide variety of copyrighted materials; in those cases, individual licenses for newsletters will not solve the problem of online copying. Nor is a license from the Copyright Clearance Center necessarily a complete solution. The CCC can only license rights which it has acquired, and a number of copyrighted works are not available for license through the CCC. *Legg Mason* teaches that a corporate policy requiring copyright compliance may reduce the amount of damages; therefore, adoption of a clear, written corporate policy is recommended. *Legg Mason* also teaches, however, that such a policy will not insulate a company from millions of dollars in liability if the policy is not followed by employees.

It will not be enough, therefore, to prepare and disseminate a written policy. In order for copyright compliance to take root within an organization, it is recommended that counsel ensure that the policy is thoroughly and repeatedly explained in employee meetings. Participation by senior management and frequent reminders can build a corporate "culture" of respecting copyright.

Finally, copyright protection is a two-way street. Virtually every business creates copyrightable—and often, quite valuable—intellectual property in the normal course of its daily operations. Protection of that intellectual property—in particular, protection of the all important remedies of statutory damages and attorney's fees—is relatively simple and inexpensive. Indeed, given the ease and low cost of securing effective copyright protection (especially in comparison with the cost of patents and trademarks), companies would be remiss in not inventorying their own copyrightable property in the course of establishing a compliance policy. An additional dividend, in the author's experience, is that companies that protect their own copyrights are much less likely to infringe the rights of others.

Joseph Beck is a partner in the Intellectual Property Practice Group of Kilpatrick Stockton LLP. A graduate of Emory College and Harvard Law School, he is a former trustee of the Copyright Society of the USA, the founder of the Society's Southeast Chapter and is (and for a number of years has been) listed in *Best Lawyers in America* for both Copyright Law and Entertainment Law. He is an Adjunct Professor of both Copyright Law and of the First Amendment at Emory University, and has lectured on these subjects throughout the United States, as well as abroad. Mr. Beck was among 12 lawyers throughout the U.S. to receive the prestigious 2002 Burton Award, which recognizes excellence in legal writing. His article was on copyright and was published in *Copyright World*.

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Verizon v. Trinko and the Uncertain Future of "Refusal to Deal" Antitrust Liability

By Michael A. Schlanger and Gregory R. Naron

More than 85 years ago, the Supreme Court held, in *United States v. Colgate & Co.*, 250 U.S. 300 (1919), that, "in the absence of any purpose to create or maintain a monopoly," a business person had no "duty to deal" with anyone; he could sell or not sell to whoever he chose. Since *Colgate*, the question has plagued law and commerce: Does a "monopolist" have a "duty to deal" with his "competitors," and, if so, under what circumstances and on what terms and conditions?

Potential "refusal to deal" liability under the Sherman Act should be of interest to all business lawyers, whether they represent a putative monopolist or competitor, buyer or seller, bricks and mortar old economy player, or high tech new economy player. You can be just a garden-variety New York area company, with a big share of a "niche" market (Chanukah candles, or maybe artificial miniature Christmas trees); have a 20-year course of profitable dealings with a bulk purchaser; decide he's a pain in the neck, more trouble than his account is worth; cut him (but not other similarly situated customers) loose; and end up on the receiving end of a "refusal to deal" monopolization claim.

In January 2004, the Supreme Court decided *Verizon Comm., Inc. v. Law Offices of Curtis V. Trinko, LLP*, 124 S. Ct. 872 (2004), a case that revisits (but does not definitively answer) the fundamental questions surrounding "refusal to deal" liability. The Supreme Court has decided on their merits only four monopolization cases in the past 32 years: *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973); *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985); *Eastman Kodak v. Image Technical Servs.*, 504 U.S. 451 (1992)—and now *Trinko*.

While it arose in a regulated-industry context, *Trinko's* potential application and effect—depending on how the lower courts interpret the case—extends across the entire industrial and commercial landscape. In particular, the Court's pronouncement that the *Aspen* case is near the "outer boundary" still leaves quite a lot of territory *within* the boundary. Just over a year after *Trinko* was handed down, this is an opportune time to examine and explain how the lower federal courts have been construing it, and how they can be expected to construe it in the future.

The *Trinko* Holding Considered. Verizon, a Regional Bell Operating Company ("RBOC"), had been the subject of federal and state regulatory investigations and monetary fines arising from its dealings with Local Exchange Carriers ("LECs"); plaintiff Trinko, a consumer, claimed Verizon's actions also gave rise to federal antitrust liability under section 2 of the Sherman Act. The Court affirmed dismissal, holding RBOCs did not have a duty to deal with a LEC beyond the statutory duty newly imposed by the Federal Telecommunications Act ("FTCA"). Thus, although the FTCA required RBOCs to permit LECs to connect (or interoperate) with them, the RBOCs did not have to do so on the LECs' terms.

While ostensibly a narrow holding, the opinion also contains passages suggesting a broader skepticism about "refusal to deal" cases generally:

> [A]s a general matter, the Sherman Act 'does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.' *Trinko*, at 879 (quoting *Colgate*, at 307).

So keen was Justice Scalia to express his disdain for refusal to deal liability that he omitted the proviso immediately preceding the passage he quoted from *Colgate*: "in the absence of any purpose to create or maintain a monopoly." Further elaborating its skeptical view, the Court observed that "[c]ompelling . . . firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities."

Nevertheless, the Court stated that "[u]nder certain circumstances, a refusal to cooperate with rivals can constitute anticompetitive conduct and violate § 2." Attempting to narrowly define those circumstances, the Court opined that its prior decision in *Aspen* was a "limited exception" to *Colgate,* near the "outer boundary" of § 2 monopolization law. (*Aspen* involved two ski-lift operators; the Court upheld a jury verdict of monopolization where defendant changed its long-standing practice and refused to participate in a multi-day, four mountain ski pass with its rival, instead offering a multi-day pass only for the three mountains it owned.)

The Court held *Trinko's* facts did not come within *Aspen's* holding because, unlike *Aspen*, there was no profitable prior course of dealings between the parties; no refusal by the monopolist to sell at retail prices; no foregoing of short-term profits for long-term gain; but instead, a willingness—indeed a statutory requirement—to deal. In *Trinko*, Verizon never "engaged in a course of dealing with its rivals, or would ever have done so absent statutory compulsion." Thus, Verizon's "prior conduct" (unlike that of defendant in *Aspen*) "sheds no light upon the motivation of its refusal to deal—upon whether its regulatory lapses were prompted not by competitive zeal but by anticompetitive malice."

The Lower Courts Interpret *Trinko*. *Trinko*'s most obvious and direct impact is in the telecommunications industry. *See, e.g., Covad Comm. Co. v. BellSouth Corp.*, 374 F.3d 1044 (11th Cir. 2004) (refusal to deal claims against regional telco "do not survive *Trinko* and must be dismissed"). But even in the telecom context, some lower courts have distinguished *Trinko* and allowed other exclusionary conduct claims to proceed. These courts have concluded that *Trinko* does not impact antitrust claims in the telecom area beyond the narrow confines of unilateral refusals to deal. "*Trinko* instructs that antitrust liability is live and well in the context of regulated telecommunications"; the issue "is whether or not Plaintiff's complaint sufficiently alleges violations of doctrinally established antitrust standards." *See Z-Tel Comm., Inc. v. SBC Comm., Inc.*, 331 F.Supp.2d 513, 527 (E.D. Tex. 2004).

Thus, in *Covad*, the Eleventh Circuit held plaintiff's price predation arguments were "based on traditional antitrust standards" and survived *Trinko.* Likewise, the "clusters of exclusionary conduct" alleged in *Z-Tel*—such as product disparagement and abuse of government processes—fell into traditional antitrust categories "not addressed in *Trinko*," and would not be dismissed. *See also Covad Comm. Co. v. Bell Atlantic Corp.*, 2005 WL 465121 (D.C. Cir., Mar. 1, 2005) (while LEC's "refusal to cooperate" with plaintiff in providing Internet service was nonactionable under *Trinko*, its refusal to deal with customers that signed up for plaintiff's service was actionable under traditional antitrust doctrine).

In the vast swath of commerce outside telecommunications and other closely regulated industries, *Trinko*'s holding is more about setting a tone than changing the law's substance. After all, the Court did not do away with refusal to deal as a basis for monopolization cases; "The bottom line is that criticism notwithstanding, the Supreme Court reaffirmed that *Aspen Skiing*'s holding about unilateral refusals to deal is good law." *Z-Tel*, at 536. However, by stating that Aspen is at the "outer boundary" of § 2—and intimating that it is an outlier altogether—the Court sent a strong signal that refusal to deal allegations may be strictly scrutinized.

Dispositive Motions. *Trinko*'s palpable skepticism about refusal to deal cases may have practical effects in § 2 litigation. Taking the Court's cue, defendants in post-*Trinko* cases have predictably argued that *Trinko* made the facts of *Aspen* the litmus test for any § 2 refusal to deal claim. Thus, in the context of a motion to dismiss or for summary judgment—where the non-movant usually gets the benefit of the doubt—*Trinko* may cause the court to read the complaint with greater scrutiny than is normally employed on such a motion.

In granting summary judgment against antitrust claimants alleging refusal to deal, several cases have explicitly referenced *Trinko*'s "caution that *Aspen Skiing* represents the 'outer boundary' of Sherman Act Section 2 liability" and "declined" to read *Aspen* "expansively." *Applera Corp. v. MJ Research, Inc.*, 2004 WL 2966653 at n.9 (D. Conn., Dec. 22, 2004); *see, e.g., MetroNet Servs. Corp. v. Qwest Corp.*, 383 F.3d 1124, 1134 (9th Cir. 2004).

On the other hand, some courts have explicitly rejected the notion advanced by some defendants that, if the plaintiff's allegations don't lie within the Procrustean Bed of *Aspen*, they are ripe for dismissal.

For example, in *Creative Copier Services v. Xerox Corp.*, 344 F.Supp.2d 858, 865-66 (D. Conn. 2004), while acknowledging that *Trinko* "emphasized that *Aspen Skiing* represents an exception to the normal rule that even a monopolist may deal or not deal with whomever it likes," the court rejected defendant's argument "that *Trinko* established a new rule in refusal to deal cases, namely, that a complaint is deficient unless the plaintiff has specifically alleged that the defendant could not possibly make a short-term profit from the challenged conduct." The court disagreed; "nowhere in *Trinko* did the Court indicate that a complaint should be dismissed if it fails to recite the magic words 'no short-term profit.'" Even "though *Trinko* did highlight that anticompetitive 'refusal to deal' is the exception, and not the rule, I do not think *Trinko* heightened the pleading standard in section 2 cases."

Foregoing Profits. As *Creative Copier* indicates, one factor post-*Trinko* courts have focused on is whether, by refusing to deal further with plaintiff, defendant was, as in *Aspen*, sacrificing an otherwise profitable relationship.

Thus, upholding a concert promoter's refusal to deal claim, the court in *Nobody in Particular Presents, Inc. v. Clear Channel Comm., Inc.*, 311 F.Supp.2d 1048, 1113 (D. Colo. 2004), noted that defendant "provided advertising and concert promotional support in the past," but "now refuses this support and sacrifices short-term gains in hopes of destroying other promoters and reaping long-term monopolistic profits. Clearly, the conduct alleged in this case bears striking resemblance to the refusal to deal in *Aspen Skiing,* conduct that the Supreme Court states is proscribed by the Sherman Act."

In *A.I.B. Express, Inc. v. FedEx Corp.*, 2004 WL 2526293, 2004-2 Trade Cases ¶ 74,621 (S.D.N.Y., Nov. 8, 2004), AIB transported gems and jewelry for merchants in the New York Diamond District; AIB and FedEx had a discount pricing agreement. FedEx attempted to directly compete with AIB, but made no significant inroads. After FedEx terminated the parties' contract some months later—right before the holiday season—AIB brought an antitrust action alleging refusal to deal. FedEx argued that *Trinko* "dictates that AIB cannot prove that FedEx engaged in anticompetitive conduct," but the court found FedEx could not get judgment on the pleadings just by denying that its relationship with AIB was profitable.

And most recently, after finding that "in order to prevail" on a refusal to deal claim, "Covad will have to prove Bell Atlantic's refusal to deal caused Bell Atlantic short-term economic loss," the D.C. Circuit held Covad's allegation that "Bell Atlantic's refusal to deal was 'predatory,' . . . suffices to withstand a motion to dismiss because, in the vernacular of antitrust law, a 'predatory' practice is one in which a firm sacrifices short-term profits in order to drive out of the market or otherwise discipline a competitor." *Covad v. Bell Atlantic,* at *7.

"[T]he existence of a bona fide short-term profit motivation may be strong, or even conclusive, evidence that the challenged conduct is not anticompetitive," but that is typically "a question for summary judgment or trial, not a motion to dismiss." *Creative Copier*, at 866, n.2. Just so, in granting summary judgment dismissing a telecom services reseller's claim that Qwest changed its pricing policies to put it out of business, *MetroNet* concluded that Qwest "was not forsaking short-term profits by switching from system pricing to per location pricing, but rather was attempting to increase its short-term profits," and hence, this conduct "'sheds no light' upon whether Qwest was 'prompted not by competitive zeal but by anticompetitive malice.'" 383 F.3d at 1132. *See also New York Mercantile Exch., Inc. v. Intercontinental Exch., Inc.*, 323 F.Supp.2d 559, 571 (S.D.N.Y. 2004) ("There is no history of cooperation between ICE and NYMEX in sharing the use of NYMEX's settlement prices," and "no indication that NYMEX is flouting consumer demand and foregoing short-term profits by refusing to cooperate with ICE").

***De facto* Regulatory Immunity.** While *Trinko* was constrained to find the FTCA's antitrust savings clause barred a finding of implied antitrust immunity, it also noted that a "factor of particular importance" to its decision was "the existence of a regulatory structure designed to deter and remedy anticompetitive harm. Where such a structure exists, the additional benefit to competition provided by antitrust enforcement will tend to be small."

The Ninth Circuit clearly took this to heart in *MetroNet*; before *Trinko*, it had "extended antitrust liability to Qwest's unilateral attempt to eliminate discount resellers like MetroNet." On remand, the court did an about face, specifically noting *Trinko's* "teach[ing] . . . that the regulatory context is an important consideration" in ruling on a § 2 claim. Even though it recognized that a unilateral attempt to eliminate resellers "can result in anticompetitive harm," the court concluded that, "given the novel nature of MetroNet's claims, the regulatory structure that exists and the record of agency action in this case—and guided by [*Trinko*]—we decline to expand the scope of Section 2 liability to Qwest's attempts to eliminate arbitrage by MetroNet." 383 F.3d at 1137.

"[G]iven Trinko*'s skeptical intimations about refusal to deal liability, future defendants can be expected to continue aggressively citing* Trinko, *and to find a receptive audience in some courts."*

Trinko's suggestion that antitrust may be displaced by regulatory structures is in some tension with its finding of no antitrust immunity—and may be the subject of future debate and litigation. At least one court has declined to create a "*de facto*" immunity defense in the context of a different regulated industry. *See In re Remeron Antitrust Litigation*, 335 F.Supp.2d 522, 531 (D.N.J. 2004) ("No authority has been cited to support the proposition that the antitrust laws have been superseded by the Hatch-Waxman Act or by FDA regulations. *Trinko* does not bar the instant antitrust claims.").

All in all, the cases decided over the past year have been generally restrained in their application of *Trinko.* However, given *Trinko's* skeptical intimations about refusal to deal liability, future defendants can be expected to continue aggressively citing *Trinko*, and to find a receptive audience in some courts.

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