New York Law Journal
Volume 225, Number 42
Copr. 2001 NLP IP Company

Monday, March 5, 2001

Outside Counsel

DO INTERNET PORTALS BAR THE DOOR TO COMPETITION?

By Matthew Laurence Cantor

A fundamental question has arisen over the relevance of the antitrust laws to e-commerce. To many, the Internet offers the promise of incredibly low barriers to entry in almost every type of product market; thereby limiting the utility of the antitrust laws to the new economy. To others, the Internet is already being dominated by a few players who have the financial and marketing support to squelch any real competition; thus making antitrust enforcement with respect to dot.com activities extremely important.

Nowhere is this debate more visibly seen than in answering the question of whether the antitrust laws are relevant to the conduct of Internet portals. [FN1] Some believe that portals, by virtue of their search engine capabilities, actively "control" traffic on the Internet. To these students (some of whom were e-commerce entrepreneurs), a preferred listing with a particular portal/search engine was seen as crucial to a Web sites business model.

Using this premise as a backdrop, one must ask whether competition law would require a dominant portal to deal with a particular Web sites on reasonable terms. The short answer is that under antitrust's "essential facilities" doctrine, to the extent that a market exists for Internet portals, a monopolist portal may have a duty to deal with its competitors.

For example, if a monopolist portal offers its own news services to consumers such as Yahoo which offers direct links to various Internet services sites (e.g., news, sports, stock quotes, auctions, etc.) it may be compelled to deal with its Internet news services competitors so as not to significantly disadvantage them from reaching consumers. [FN2]

This leads to one further question: are there any portals that currently have sufficient economic power to trigger a duty to deal with its competitors on reasonable terms? At this time, there is strong evidence that would suggest that no portal even Yahoo has such power, although contrary evidence does exist. With possible consolidation in the portal "market" and with major players finding it difficult to compete in this business (such as

Disney), there may come a time when such power is accrued by a particular portal.

Analysis mandates that, under certain circumstances, a dominant portal/search engine would have a duty to deal with competitors and supports the conclusion that currently no entity has gathered enough economic power in an Internet portal/search engine market to trigger this duty to deal.

Essential Facilities

It is a maxim that competitors generally have no duty to deal with one another. This right, however, is not unqualified. [FN3] When a business with significant market or monopoly power owns a facility that is essential to competition in a given relevant market, it has been determined that it has a duty to deal with competitors "on just and reasonable terms." [FN4]

This duty to deal is heightened where "the monopolist did not merely reject a novel offer to participate in a cooperative venture that had been proposed by a competitor. Rather, the monopolist elected to make an important change in a pattern of distribution that had originated in a competitive market and persisted for several years." [FN5] Accordingly, where a monopolist who controls an essential facility has provided his competitor access to that facility for a period of time, the antitrust laws affirm a duty to continue such dealing.

It should be noted, however, that courts will generally only impose a duty to deal on a monopolist who owns an essential facility where " 'duplication of the facility would be economically infeasible' and that 'denial of its use inflicts a severe handicap on potential [or current] market entrants.' " [FN6]

Thus, in general, a heavy burden would be placed on a plaintiff claiming that a particular portal was an essential facility. Of course, it would not be impossible for this plaintiff to satisfy this threshold if it could prove that a market for portals could be defined, that the defendant portal had monopoly power in this market and that the barriers to entry in this particular market were high.

Antitrust Market?

Whether or not a particular business exercises economic power, it is necessary to define the relevant market in which the business operates. In other words, one must first define the scope of the pie before measuring the particular slice held by a business. Thus, to determine whether a particular

Internet search engine wields monopoly power, we must first question whether a market consisting only of portal Web sites exists.

A relevant market is defined by "the reasonable interchangeability of use or the cross elasticity of demand between the product itself and substitutes for it." [FN7] Two products are deemed to be in different markets if a significant, non-transitory price increase for one product will not cause enough consumers to switch to the other product to render the price increase unprofitable. [FN8] In other words, if the price of advertising on or using portals increased by five percent, and consumers cannot find sufficient substitutes for these portals, but instead continue to pay the inflated price for portal usage, a relevant antitrust market for portals and only portals would be deemed to exist. [FN9]

Arguably, neither consumers nor merchants who contract with these portals would be able to sufficiently substitute for portal sites in the wake of a significant non-transitory price increase because of the unique search engine services that these portals provide. Consumers need these portals to "surf" the Web. Merchants need to contract with these portals so that consumers can readily find their sites.

Assuming that there is a market for Internet portals, we must then ask the question whether any of them wield monopoly power in that market. Monopoly power is defined as the power to raise prices in a relevant market or reduce output. In reviewing whether a particular entity wields monopoly power, courts generally review the share of the market held by that monopolist as well as other factors, including the existence of barriers to entry, market trends and the relative elasticity of supply and demand. [FN10]

According to Media Metrix a company that measures the number of "hits" that Web sites receive on a monthly basis, there appears to be no particular portal/search engine that currently wields monopoly power. [FN11] For example, in the month of October 2000, Yahoo received approximately 56 million hits, Lycos received approximately 31 million hits, Excite received approximately 30 million hits, Go received approximately 22 million hits, About received approximately 22 million hits and Alta Vista received approximately 19 million hits.

If these players constituted the entire portal market which they do not Yahoo would only have approximately 31 percent of the market, well short of the approximately 70 percent market share that some courts regard as evidence of monopoly power. [FN12] (Of course, it is settled that market share data cannot be referred to exclusively in deciding whether a specific entity wields market or monopoly power.)

Yet, other evidence seemingly indicates that Yahoo while perhaps not attaining monopoly status at present wields significant economic power in the portal market. For example, rates for targeted advertising on Yahoo are almost thirty times as high as it is for other portals. [FN13] Yahoo apparently justifies these higher rates, in part, because of the vast audience that it repeatedly reaches. If Yahoo's power should continue to increase in this manner, it may one day be deemed a monopolist in the portal market.

Conclusion

While a case for monopolization could not be credibly made against portals, including Yahoo, at this time, these portals should consider the effect of the antitrust laws on their future business dealings. As certain of these Internet players gather greater market power, they should be aware that their ability to refuse to deal with their competitors on reasonable terms could be limited.

FN(1) For the purpose of this article, Internet portals are defined as those Web sites that offer search capabilites as well as other Internet services such as news, real-time stock quotes, and auctions. Typically, these portals are the default Web site that appear on an end user screen when that end user enters cyberspace. Examples of portals are Yahoo, Excite, About, etc.

FN(2) "Today Yahoo is a digital amusement park with 400 different services. Millions of people use Yahoo every day for e-mail, instant messaging, scheduling, Web photo albums, personal home pages, shopping, bill paying, games, auctions and more." Id. At 174.

"Yahoo's two original services, directory and search, now grab only 20 [percent] of the Web site's total page views. The other 80 [percent] comes from what Koogle has been acquiring and adding." Id. at 176.

FN(3) Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 601 (1985).

FN(4) United States v. Terminal Railroad Ass'n Of St. Louis, 224 U.S. 383, 411 (1911); See MCI Communications Corp. v. American Telephone & Telegraph, 708 F.2d 1081, 1132 (7th Cir. 1983) ("A monopolist's refusal to deal under these circumstances is governed by the so-called essential facilities doctrine. Such a refusal may be unlawful because a monopolist's control of an essential facility (sometimes called a "bottleneck" can extend monopoly power from one stage of production to another and from one market into another. Thus, the antitrust laws have imposed on firms controlling an essential facility the obligation to make the facility available on non-discriminatory terms.")

FN(5) Aspen Skiing Co., 472 U.S. at 603.

FN(6) Twin Laboratories, Inc. v. Weider Health & Fitness, 900 F.2d 566, 568 (2d Cir. 1990) (quoting Hecht v. Pro-Football, Inc., 570 F.2d 982, 992 (D.C. Cir. 1977)).

FN(7) Brown Shoe Co. v. U.S., 370 U.S. 294, 325 (1962).

FN(8) F.T.C. v. Staples, Inc., 970 F. Supp. 1066, 1074-75 (D.D.C. 1997).

FN(9) See 1992 Horizontal Merger Guidelines, 57 Fed. Reg. 41552 Sec. 1.11.

FN(10) See E.I. du Pont de Nemours & Co., 351 U.S. 377, 391 (1956); Reazin v. Blue Cross & Blue Shield, 899 F.2d 951, 967 (10th Cir. 1990).

FN(11) See www.mediametrix.com.

FN(12) For example, this list does not include AOL's Web-based portal or HotBot. See ABA Section of Antitrust Law, Antitrust law Developments (4th ed. 1997) at 235 ("[a] market share in excess of 70 [percent] almost always is deemed sufficient to support an inference of monopoly power").

FN(13) For example, advertisers, who wish to target specific demographics, apparently view Yahoo as an incredibly important Web site. See Forbes, "The Killer Ad Machine," at 170 (Dec. 11, 2000)

Elsewhere in cyberspace the cost of ordinary banner ads has fallen 75 [percent] in a year, to less than $5 per 1,000 impressions (cost per thousand or CPM). That's the cost of a two-inch display ad in a paper with 40,000 subscribers. At Yahoo, targeted ads can draw a $156 CPM. That works out to the equivalent of nine times the cost of a 30-second TV spot during the Super Bowl. Yahoo's tailored e-mails to specialty groups are even pricier a CPM of $300, triple the price of a full-page ad in a business magazine. The Yahoo machine could get only more powerful as high-speed broadband services expand and it combines the "rich media" of TV spots with the instant interactivity of point- and-click on the Web.

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New York Law Journal
Volume 222, Number 107
Copr. 1999 NLP IP Company

Thursday, December 2, 1999

Corporate Update
Telecommunications Law

CURTAILING MONOPOLY LEVERAGING IN LONG DISTANCE MARKETS

By Matthew L. Cantor

With the enactment of the Telecommunications Act of 1996, [FN1] a brave, new world of competition has arisen in the telecommunications arena - a world in which, if permitted by the Federal Communication Commission, regional bell operating companies (RBOCs) will provide in-region long distance (also known as "interLATA") services.

The FCC has not yet consented to RBOC entry into the interLATA markets. However, based upon the FCC's decision concerning Bell South's application and the New York Public Service Commission's support of Bell Atlantic's recent application, [FN2] the question does not appear to be if RBOCs will be granted permission to compete in the long distance markets, but when.

The prospect of having RBOCs - which currently control the access networks through which virtually all Americans are provided with telephone service - providing long distance service from their particular regions confronts current long distance providers with the prospect that their future business opportunities may be squelched.

Thus, without procedures sufficient to curtail RBOC "monopoly leveraging" - i.e., the use of RBOC monopolies in the local markets to gain an advantage in the long distance markets - the purpose of the 1996 Act, which is to promote more competition in the telecommunications industry, may well be compromised.

The purpose of this article is to identify the relative strengths and shortcomings of the two current procedures aimed at curtailing RBOC monopoly leveraging, which are rooted, respectively, in the 1996 Act and the antitrust laws. [FN3] Notably, 271(d)(6) of the 1996 Act provides for a summary procedure, to be adjudicated by the FCC, to assess whether an RBOC is continuing to satisfy the specific conditions for inter-LATA entry, and specifically, whether RBOC participation in the interLATA market serves the "public interest."

Under the statute, the FCC is given broad powers, including the power to enjoin conduct, assess damages, or strip an RBOC of its right to participate in an interLATA market, if it no longer acts in accordance with the "public interest." Accordingly, this proceeding is expected to provide a cost-effective measure to fight RBOC monopoly leveraging, if the FCC determines that specific monopoly leveraging conduct is contrary to the "public interest.''

The FCC has yet to preside over a 271(d)(6) proceeding, however, and the standards governing this procedure are yet undetermined. Moreover, the summary 271(d)(6) procedure may lack finality insofar as the FCC may be required to enforce 271(d)(6) orders in the federal district courts, where such orders may be contested by the RBOC or complainant.

Alternatively, monopoly leveraging can be curtailed by antitrust litigation. While this may prove to be the more expensive option for a private litigant, it does have its benefits: One hundred years of antitrust jurisprudence provides greater certainty and predictability than the unsettled standards/law the FCC will employ in its 271(d)(6) proceedings, and an antitrust plaintiff is empowered by the added leverage of the Sherman Act's treble damages provisions.

In sum, a 271(d)(6) proceeding would seem an appropriate vehicle for RBOC competitors with a lesser ability to absorb the cost of a full-blown antitrust suit or for those who are in need of a speedy decision concerning contested RBOC conduct, even though, due to a dearth of precedent, it may prove risky to litigate.

Conversely, an antitrust suit favors those who have deeper pockets or wish to utilize the leverage of the Sherman Act's treble damages provision and be guided by the relatively clearer antitrust laws.

The purpose of the 1996 act is best summarized in the words of Chairman William Kennard of the Federal Communications Commission: "the fundamental commitment of the Telecommunications Act of 1996 [is] to bring consumer choice to all telecommunications markets, including both local and long distance.'' [FN4] The 1996 Act mandates that local exchange carriers, such as RBOCs, open their networks to competitors wishing to enter the local markets. For example, Justice Antonin Scalia recently noted that" [f]oremost among [a local exchange carrier's] duties is to share its network with its competitors.'' [FN5]

While the 1996 Act requires RBOCs to open their local networks to competitors, it also provides the opportunity for a RBOC to provide interLATA exchange upon receipt of approval from the communications commission of the subject state and the FCC. [FN6]

The Application Process

Section 271(d) of the 1996 Act provides the standards by which the FCC will judge whether RBOCs should be permitted to enter the interLATA markets. According to that section, the FCC's decision to approve is to be based on the following: (1) whether the particular RBOC satisfies a fourteen point competitive checklist governing compliance with the RBOC's obligations to open its networks to other competitors in the local market, (2) whether "the requested authorization is consistent with the public interest, convenience and necessity" and (3) whether the anticipated long distance services will be provided by an arms' length affiliate - required by 272 - for a specified duration. [FN7] Section 271(d) also mandates that the FCC issue a decision on the application within 90 days from the filing of the papers supporting it.

Monopoly Leveraging

There has been an expressed concern that RBOCs will be tempted to capitalize on their dominance in the local market either to bolster their position (or their 272 affiliate's position) in the long distance market or to penalize other long distance carriers who must utilize RBOC networks in order to provide their service. [FN8] If, however, an RBOC were to misuse market power in order to gain an improper advantage over its long distance competitors, the RBOC's activity could constitute impermissible monopoly leveraging. [FN9] Assuming monopoly leveraging is contrary to the "public interest," if monopoly leveraging were to occur, one of the predicates of 271 interLATA admission would no longer be satisfied. [FN10] Whether such conduct is subject to 271(d)(6) review, however, has yet to be litigated.

The 1996 act, by opening local markets, is designed to assist in abrogating the monopolies held by the RBOCs so as to reduce the chance of monopoly leveraging. However, based on the fact that interLATA entry seems imminent and that RBOCs still currently account for practically all local service provided in this country, [FN11] it appears doubtful that RBOCs will be fully divested of their ability to leverage before they are granted permission to supply long distance service.

For example, 272(g)(2) of the 1996 Act permits RBOCs to "market or sell interLATA service provided by an affiliate" once it is authorized to provide interLATA service. Accordingly, one can expect RBOCs to enclose advertisements promoting the long distance services of the RBOC's affiliate with their invoices.

RBOCs could also enter into agreements with their affiliates in which they will agree to shut down a customer's long distance and local service if the long distance service portion of a bill is not paid. Although Section 272 requires RBOCs to offer long distance competitors "services" on a non-discriminatory basis once interLATA approval has been obtained, it is unclear whether the section could require an RBOC to agree to discontinue its local access if other long distance providers are not being paid their portion of a long distance bill. [FN12] If an RBOC could engage in this conduct, it would provide its affiliate with a means to coerce payment from its customers not available to other long distance carriers.

Finally, once the requirement for a 272 affiliate expires, if the RBOCs are able to maintain their local monopolies, they will have the ability to shift their pricing criteria so as to undercut other long distance competitors without incurring adverse effects in the local markets. [FN13] In other words, they will have the power to increase their local rates so as to subsidize their long distance operations.

Enforcement

Anticompetitive conduct engaged in by the RBOCs can be challenged either under an expedited 90 day procedure set forth by 271(d)(6) or by antitrust litigation.

Section 271(d)(6) provides: ENFORCEMENT OF CONDITIONS:

(A) COMMISSION AUTHORITY - If at any time after the approval of an application, the Commission determines that a [RBOC] has ceased to meet any of the conditions required for such approval, the Commission may, after notice and opportunity for a hearing

(i) issue an order to such company to correct the deficiency;

(ii) impose a penalty on such company ; or

(iii) suspend or revoke such approval.

(B) RECEIPT AND REVIEW OF COMPLAINTS - The Commission shall establish procedures for the review of complaints concerning failures by [RBOCs] to meet conditions required for approval. Unless the parties otherwise agree, the Commission shall act on such complaint within 90 days.

Thus, for instance, if a complaint is made that a RBOC or its 272 affiliate had engaged in activity which is contrary to the "public interest," that matter could be subject to the FCC's broad jurisdiction to fashion corrective injunctive remedies and penalties. The FCC has also stated that it is empowered to award damages in such a proceeding. [FN14]

Standards for Challenge

In a notice and order concerning the Implementation of the Non- Accounting Safeguards of 271 and 272 of the Communications Act [FN15] (Non- Accounting Safeguards), the FCC adopted some standards for a 271(d)(6) challenge, many of which are similar to those governing most civil litigations. However, the FCC has yet to establish certain standards that could prove crucial to a claim of monopoly leveraging - most notably the proper burden of proof and the specific test to be used in order to determine whether alleged conduct is contrary to the "public interest.'' [FN16]

For example, in order to prove a violation, the FCC has stated that, in general, the complainant will likely have to satisfy a "preponderance of the evidence" standard. However, the FCC has qualified this statement by asserting that the evidentiary standard to be used in a 271(d)(6) proceeding will depend on the allegations made.

District Courts

The FCC in and of itself does not have enforcement mechanisms and must seek a court order when dealing with a recalcitrant party. However, the FCC is authorized, upon violation of an order pursuant to 271(d)(6), to seek from a district court an order commanding compliance.

However, it is unclear what standard of review will be applied to 271(d)(6) orders. In general, the decisions of administrative agencies, such as the FCC, have been subject to one of two levels of judicial review. Historically, the "substantial evidence test" has been applied to formal adjudications and rulemaking while the arguably more deferential "arbitrary and capricious" test has been applied to informal adjudication and rulemaking.

The Administrative Procedure Act (APA) reflects this dichotomy by mandating substantial evidence review only for findings adopted through "formal" procedures. To date, a 271(d)(6) proceeding has yet to be characterized by a court as "formal.''

Curtailing Leveraging

For the purpose of bringing a monopoly leveraging suit against an RBOC, "nothing in the Act or the amendments made by the Act shall be converted to modify, amend, or supersede the applicability of any of the antitrust laws.'' [FN17] Accordingly, an antitrust claim may be brought against an RBOC in federal court.

The standards and law governing a monopoly leveraging claim in federal court are relatively more certain than those that have yet to will be employed by the FCC in a 271(d)(6) proceeding. Moreover, the Sherman Act provides for a powerful treble damages remedy, making an antitrust suit an attractive alternative for a "deep pocket" plaintiff.

In order to prevail on a monopoly leveraging case, a plaintiff must prove that the RBOC utilized its monopoly to gain advantage in an interLATA market. In order to do this and in order to give the defendant an opportunity to substantiate any defenses or counterclaims which it may assert, the antitrust plaintiff could be subject to extensive discovery, including the production of voluminous documents and numerous depositions - a process seemingly spared under the expedited procedures of 271(d)(6). Moreover, the plaintiff would most likely be subject to the cost of motion practice - perhaps, both in the context of discovery and in dispositive motions.

Conclusion

RBOC monopoly leveraging poses a very real and imminent threat to long distance competitors. These long distance entities need not be powerless victims, however, but rather may seek redress for such leveraging by litigating before the courts or the FCC. It is important though that a potential telecommunications litigant consider the goals and risks of such litigation before choosing whether it should pursue the summary FCC proceeding discussed herein or antitrust litigation. As noted, while the FCC procedure may be concise and cost-effective, it may not prove to be an effective means of curtailing all acts of monopoly leveraging.

The antitrust litigation option is certainly more lengthy and expensive, but is governed by clearer standards and allows for the added bonus of treble damages. Each option should thus be thoroughly analyzed before a litigation course has been adopted.

FN(1) See Telecommunications Act of 1996, 110 Stat. 56 (codified as amended 47 U.S.C. 151 et. seq.). [Hereinafter "1996 Act''].

FN(2) See "New York Backs Bell Atlantic In Bid To Offer Long Distance," The New York Times, Oct. 20, 1999 at C11.

FN(3) Because most of the standards concerning antitrust litigation are relatively well established, this article primarily focuses on the procedure established by the 1996 Act.

FN(4) Comments of Chairman Kennard Concerning Bell South's Application To Provide Long Distance Service in Louisiana - an application which was denied on October 13, 1998. See FCC Rep. No. CC 98-34, 1998 FCC Lexis 5284 at *14.

FN(5) AT&T Corp. v. Iowa Utils. Bd., 67 U.S.L.W. 4104 (1999); see 251(d).

FN(6) Section 271(d) of the 1996 Act.

FN(7) See 271(d)(3) and 272.

FN(8) In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, 5 Comm. Reg. (P & F) 696, at 7. [Hereinafter "Non-Accounting Safegards''].

FN(9) "The use of monopoly power in one market to monopolize or attempt to monopolize another market has been held to violate Section 2." ABA Section of Antitrust Law, Antitrust Law Developments (4th Ed. 1997) at 282; Berkey Photo v. Eastman Kodak Co., 603 F2d 263 (2d Cir.1979).

FN(10) See e.g., Paragraph 5 of the Non-Accounting Safeguards stating that the RBOCs will be permitted to provide long distance service if "they satisfy certain statutory conditions that are intended to prevent them from improperly using their market power in the local exchange market against their competitors in the interLATA telecommunications [market] and if they have taken sufficient steps to open their local exchange networks to competition.''

FN(11) For example, Russell Frisby Jr., Chairman of the Maryland Public Service Commission, stated that as of 1996 "Bell Atlantic still has a 90-plus share of the market." See Liz Skinner, "The Telecom Revolution Hits Home In Md.," Warfield's Bus. Rec., March 11, 1996 at 1.

FN(12) Section 272(c), of the 1996 Act, entitled NONDISCRIMINATION SAFEGUARDS, states, in relevant part: In its dealings with its affiliate described in subsection(a), a Bell operating company - (1) may not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards.

FN(13) However, the FCC may interpret that shutting off its local service to a customer who has refused to pay a long distance bill is not a "service" provided under this section. The FCC can choose to expand the requirement of a section 272 affiliate, if it so chooses. See 1996 Act 272(f)(2).

FN(14) See Non-Accounting Safeguards, at 333.

FN(15) See Non-Accounting Safeguards.

FN(16) Noted procedural standards that have been promulgated by the FCC for a 271(d)(6) hearing are that (1) complaints "must plead, along with proper supporting evidence, facts which, if true, are sufficient to constitute a violation of the act in order to establish a prima facie case," (2) a presumption of reasonableness will not be employed in favor of the RBOC and, (3) "the burdenof production or coming forward with evidence will shift to the defendant [RBOC] once the complainant has established a prima facie case.''

FN(17) Section 601(6)(1) of the 1996 Act Curtailing Baby Bell Monopoly Leveraging

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