FTC/DOJ Hearings on Section 2 of the Sherman Act:
Single-Firm Conduct as Related to Competition[1]

Wednesday, March 7, 2007
2:00 pm - 4:30 pm EST
(As reported by Amanda Wait of the Federal Trade Commission)

The joint Federal Trade Commission and Department of Justice Hearings on Section 2 of the Sherman Act: Single-Firm Conduct as Related to Competition continued on March 7, 2007, in Washington, DC, with morning and afternoon panels exploring monopoly power. David P. Wales, Jr., Deputy Director for the Bureau of Competition at the Federal Trade Commission, and Gregory J. Werden, Senior Economic Counsel at the Antitrust Division of the U.S. Department of Justice, moderated the afternoon panel.

This summarizes the hearing's afternoon panel. Each panelist provided a short presentation then Mr. Wales and Mr. Werden led a brief roundtable discussion. The panelists' written materials are available on the FTC's website at http://www.ftc.gov/os/sectiontwohearings/index.htm.

Mr. Wales began the session by noting that after these hearings on monopoly power, the hearings will turn to the issue of remedies in late March.

Simon Bishop

Simon Bishop is a Partner and co-founder of RBB Economics.

Mr. Bishop noted that his remarks are euro-centric, reflecting his experience, but would remain applicable to U.S. antitrust law. He noted that the EC is engaged in ongoing reform with respect to its monopolization act, Article 82. He said that last year the EC issued guidelines on how to reform Article 82 and move from a form-based to an effects-based approach. He noted, however, that these guidelines contain an elephant in the room: the concept of dominance based on structural market shares. Determining a violation of Article 82 contains two inquiries: (1) is the firm dominant, and (2) does the behavior at hand constitute an abuse of this dominant position. Mr. Bishop noted that the focus has been on second prong of this test, such that dominance and market definition analyses are paramount. He noted that the Merger Guidelines in the United States, through the hypothetical monopolist and "SSNIP" tests, have provided an appropriate framework

[1] This document is intended to summarize the FTC/DOJ Hearings on Section 2 of the Sherman Act: Single-Firm Conduct as Related to Competition and is not intended as a primary source document. Although the author strives for reporting accuracy, this summary is based on the author's own notes and impressions from the hearings. Any errors or misrepresentations are inadvertent and deeply regretted. For a complete transcript of the hearings and the panelists' written materials, please visit the FTC's website at www.ftc.gov/os/sectiontwohearings/index.htm.

in which to assess relevant markets, but even so this framework can be quite hard to implement in individual cases. He noted that in abuse of dominance cases, the Cellophane Fallacy makes implementing this framework even harder.

He explained that in the merger context we are concerned about what the merger changes. The implication is that we can use existing data to assess the strength of competitive constraints on the products involved. In monopoly cases, however, the relevant issue is not whether prices are going to increase, but rather have prices already increased above competitive levels. Thus, using observed data tends to overstate the competitive restraint.

He noted that several approaches have been proposed to address the Cellophane Fallacy. One proposal, for example, is to use only the hypothetical monopolist test to define the relevant market. The hypothetical monopolist test requires you to think about demand and supply side competition, both of which are necessary parts of the inquiry. A second approach is to recalculate prices starting with the competitive price. Mr. Bishop suggested that this is a good idea, but noted that it may not be useful because if we knew the competitive price we would not need to determine the relevant market in the first case. Providing an example from the *Microsoft* case, Mr. Bishop asked what is the competitive price that Microsoft should charge? The only easy answer is that they should charge some price less than what they are charging now. A third approach is to ignore that the Cellophane Fallacy exists. Ignoring the Cellophane Fallacy, however, would result in markets being defined too broadly. A fourth option is to ignore market definitions altogether and go straight to the ultimate question of anticompetitive harm. He suggested that if we see market definition for what it is–an interim analysis–then it is useful to provide a good touchscreen for analysis.

He concluded that we are stuck with the "SSNIP" test as a framework and also with the implications of the Cellophane Fallacy. He proposed, however, that structural analysis can be a useful filter: by recognizing that the Cellophane Fallacy exists we can define relevant markets that are consistent with a hypothetical monopolist test, and using the "SSNIP" test can provide useful discipline on defining markets. If the Cellophane Fallacy exists, we must be able to show that substitution exists at prevailing prices.

Making one final comment, Mr. Bishop pled for humility. He noted that in many cases the available evidence will not let us discriminate between the broad and narrow market definitions. The difficulty is where a firm has a high market share if the market is defined narrowly but a low market share when defined broadly. He suggested in these cases we need good evidence of business conduct. He suggested that we continue to watch the EC because it is moving in the right direction and focusing on form.

Miguel de la Mano

Miguel de la Mano is a Member of the Chief Economist Team, Directorate General for Competition, for the European Commission.

Mr. de la Mano indicated that his remarks would offer a review of the way in which dominance plays a role in competition policy in Europe as enshrined in Article 82. He noted that the Commission is in the process of reviewing Article 82. Although constrained by case law and practice, the Commission believes that it is the right time to align the implementation or enforcement of Article 82 to current thinking and economic knowledge.

He began his remarks by making an obvious, but crucial, comment: in the context of the analysis of monopolization, dominance is a necessary condition. This rules out the concept of "attempted monopolization" from EU competition law. If a firm is not dominant in the first place, then it cannot violate Article 82. He underscored the importance of this point because there is a myth that the EU is concerned with type II errors (false acquittals)–he does not think that is the case because the analysis: (1) provides legal certainty; and (2) the responsibility for the analysis was delegated to the Commission from the member states.

He noted, however, that requiring a finding of dominance as a prerequisite to a violation of Article 81 has not fully worked. First, the concept of dominance is elusive. The concept of dominance was included in Article 82 by the member states without a definition of its meaning. Courts have reacted to the cases brought to them resulting in a definition of dominance that has become increasingly complex over time. Assessing dominance almost has become an end in itself.

He stated that dominant firms should be equated with substantial market power. He suggested that the real question should be whether the market power that exists is important, not whether market power is present. He explained that no firm is fully independent of customers and competitors, but measure of this sensitivity to the action of others is given by an elasticity, which can be a measure of market power. To show that a firm has substantial market power, a plaintiff should have to argue that the market share is both important and provides a good proxy for sensitivity of firm to actions of competitors and customers. He also noted that we have to consider market characteristics, such as barriers to entry and expansion.

He suggested that the acid test is to ask whether the firm is the most efficient in the market, because if it is then it is likely to have high market share and high barriers to entry. He suggested that a firm should not fear that an assessment of dominance will lead to a finding of anticompetitive behavior; instead, a finding of dominance should mean that the firm is the most efficient in the market.

Mr. de la Mano suggested that a finding of dominance is not the end of the analysis. Dominance is a filter. He said that it is clear that if a practice is anticompetitive than the firm must be dominant, but noted that it is hard to determine what practices are anticompetitive. He cautioned, however, that dominance is a screen that bites–not all large firms may be dominant.

In conclusion, he advocated the use of market shares as a safe harbor, but cautioned that not only market leaders can be dominant. He said that safe harbors make sense, but the thresholds should be set low because rivals may be constrained, some market characteristics may impact

dominance, or market leaders may be constrained by regulation or new entry. Regarding market delineation, he noted that he agreed with Mr. Bishop that we ought to be humble, but indicated that sometimes the Commission is forced to be arrogant–they have to say what they think whether or not they bring a case. He said that we do not have to lose all hope, however, because dominance is a screen that goes a step further than the "SSNIP" test, asking how much are competitors constraining the incumbent. He noted that the real issue in dominance cases is market power.

Thomas G. Krattenmaker

Tom Krattenmaker is Of Counsel at Wilson Sonsini Goodrich & Rosati. He based his remarks on an article that he published with Robert Lande and Steve Salop in 1987.[2]

His first point is that most antitrust practitioners and scholars today agree that market power is the ability to price above the competitive level for a significant period of time. He noted that this has not been always the case. Explaining the difference between monopoly and market power, he suggested that some believe that "monopoly power" implies control of 100% of relevant antitrust market. He claimed, however, that monopoly power and market power are the same and that the law does not really distinguish between them. He said that monopoly and market power can occur in various degrees, but they are qualitatively the same–like shots in basketball. Third, he indicated that he thinks distinguishing between the two types of market power is helpful. He explained that a firm can exercise market power by restricting its own output (collusive or "Stiglerian" market power) another way is to restrict the output of others (exclusionary or "Bainian" market power).

He then turned to the question of whether thinking about the source of market power is relevant in Section 2 cases. He noted that market and monopoly power includes the power to keep prices from falling to competitive levels. When confronted with the ability to keep prices from falling, we should recognize this as market power. He also pointed out that insisting on a threshold showing of market power is improper if the alleged conduct results in the exclusion of rivals. He explained that exclusionary behavior can create market power, and it is not necessary to already control the market to use this power.

He noted that the exercise of market power is not prohibited by antitrust law. He said that this probably is true for collusive (Stiglerian) market power, but the real question is how the firm obtained the market power. If the market power is based on exclusionary market power, then the exercise might violate Section 2.

Finally, he noted that private plaintiffs have to worry about standing to bring antitrust suits. He suggested that competitor standing should not be an issue in cases involving exclusionary market power, but on the other hand, consumer standing is quite risky because there is a more direct subject

---

[2] *See* Thomas G. Krattenmaker *et al.*, *Monopoly Power and Market Power in Antitrust Law*, 76 GEO. L.J. 241 (1987).

of harm–the competitor–so there is a risk of double damages. Some case law suggests that consumers do not have standing to bring attempted monopolization cases.

Mr. Krattenmaker concluded that he tried to suggest two things in his remarks: first, that we have a concept of market power that we are comfortable with and that is no different than monopoly power; and second, that it would help further our understanding of Section 2 to keep our eye on the ball by digging deeper and asking whether the market power will be manifested by restricting the firm's own output or by driving rivals out of the market. These remarks have many lessons for Section 2 analysis.

Irwin M. Stelzer

Irwin Stelzer is the Director of Economic Policy Studies and a Senior Fellow at the Hudson Institute. Mr. Stelzer began his remarks by commenting that he does not want to appear as a disinterested scholar, that he will not comment on specific cases, and that he wanted to use this panel to try out new ideas regarding the pricing practices of dominant firms.

He noted that Mr. Bishop said that if a firm is dominant, then the practice is questionable, but Mr. Stelzer said that he thinks that if a practice is questionable, then the firm is probably dominant. He said that the agony of market definition provides some constraint, but that he would like to explore the possibility of eliminating the market definition inquiry completely.

He suggested that we consider the proposition that anticompetitive practices reveal dominance, not that dominance reveals anticompetitive practices. He indicated that he wants to dismiss the "motherhood and apple pie" stuff in this record. Although he agreed that we do not want to prevent rigorous competition and that we want to give businesses as much certainty as possible, we do not want to do long-term harm to the competitive process. He challenged us to determine the costs of any firm and tell him what range of costs would be comfortable. He said that we have to examine pricing practices in the context of the firm's total behavior to get a picture of whether or not a firm is violating Section 2. He noted that firms spend millions on discovery in antitrust cases, and that discovery tells you whether firm is dominant with far greater certainty than would any measure of market share. He also noted that one also can determine a firm's intent through discovery.

He concluded by asking whether consideration of market power has reduced certainty. He suggested that we can achieve certainty two ways–either through per se rule legality or per se illegality–neither one of those is a good option. Thus, he concluded that certainty just is not possible in evaluating exclusionary conduct under Section 2.

Joe Sims

Joe Sims is a Partner at Jones Day.

Mr. Sims began with the revelation that he has been practicing antitrust law for about one-third of the time that we have had a federal antitrust law. He noted that his role in this panel would be to provide the practitioner perspective.

He noted that antitrust law is heavily fact-weighted–it is about the facts and how they are presented. Although case law is important, he noted that it fades in importance relative to the facts in play in any given case. He noted that, over time, antitrust analysis has moved away from sloganeering to a more careful analysis of the facts. He explained that when the analysis focuses on competitive effects, the notion of bright line tests disappears. Today in merger cases no bright line rules exist–every case is unique. He said that he thinks this is equally true in Section 2 cases.

He said that the general direction of Supreme Court antitrust cases is to cabin-in the reach of Section 2 by focusing on the facts, rather than relying on market dominance or the size of the relevant market. He suggested that this reflects the fact that markets have matured, which was not always the case. Nevertheless, he pointed out that not as many clear rules exist in Section 2 today. For example, a *Microsoft* representatives in a prior hearing advocated clarity in the law. Mr. Sims suggested that this view is short-sighted: if we have more clarity, we would have more restrictive rules, which are not useful for either the public interest or businesses in long run.

Mr. Sims continued by noting that these hearings are a good idea, particularly if they consider the long run view of the law. He noted that past panel discussions have revealed a wide variety of views on Section 2. He specified Mr. Krattenmaker and Professor Salop as responsible for the most visible efforts in this field, but noted that many others are in their company, including Greg Werden and others on the panel. He pointed out, however, that clearly no consensus exists on any particular approach, other than that we need to pay attention to the facts. He said that it is unclear to him how to develop safe harbors given this lack of consensus on where to draw the lines. Although the chances of finding consensus on bright line rules is pretty low, he recommended that it still is a worthy topic of discussion.

He noted that any legal discipline where the standard is a rule of reason analysis is going to be messy because the facts involved necessarily are messy and because courts and regulators are inevitably better at evaluating the past than predicting the future. Placing himself in the "do no harm" school of thought, he cautioned against interfering in markets without certainty that the intervention will not cause more harm.

.

Overall the rule of reason analysis is a good description of what the courts and regulators really do in antitrust analysis. He suggested that, to the extent possible, we should leave markets free to work their magic. He noted that as long as this rule of reason regime exists we will have uncertainty, but he suspects that the costs of uncertainty are less than costs of incorrect bright line tests. He said we should strive to develop new rules if possible, but they may not be necessary. He also cautioned that in developing rules, we have to remember the difference between Section 1 and Section 2–Section 1 deals with joint conduct that results in competitive risks in many situations, but overenforcement of Section 2 could threaten the very essence of competition. The more risky we

make the effort to compete, the more we discourage firms from being efficient and competing aggressively.

Panel Discussion

After the individual presentations, Mr. Wales and Mr. Werden led a brief roundtable discussion.

Mr. Werden began by asking the panelists whether the standard for dominance should be low. Mr. Bishop responded that if market share is below 40% then a firm can do whatever it wants, but if it has a market share higher than that, it will have to consider potential competitive effects. He cautioned however, that a market share above 40%, with nothing else, is not sufficient to prove a violation of Section 2–market share is only one factor to assess whether a firm has significant market power. Mr. Krattenmaker suggested that there should not be a bar to proceeding in the United States because we have to consider several facts. On the other hand, Mr. Krattenmaker did not advocate utterly disregarding consideration of market share, but noted that the ability to exclude does not require dominance of an entire relevant market. Mr. Stelzer added that a firm would have to have a very large market share in order to induce another firm to do something it did not want to do. He also added that consideration of market shares was not necessary in *Microsoft*. Mr. Krattenmaker responded that if Mr. Stelzer was talking about the part of the *Microsoft* case in which Microsoft misrepresented how they interfaced with Java, then Mr. Stelzer is correct that the court did not need to address market shares in order to determine the lie. Mr. Sims added that market definition can be a useful tool at times, but noted that there may be times when careful market definition is not useful or important. Mr. Bishop noted that this discussion reflects the institutional differences between the United States and the European Commission. In the United States the consideration is to "do no harm," which is a high threshold, but in Europe the Commission sees many markets in which it could intervene to improve competition. Mr. Stelzer asked Mr. Bishop whether the rule is for the Commission to chose the "lesser of the two evils." Mr. Bishop replied that is not the rule. Mr. Sims pointed out a further difference between the United States and the European Commission–in the United States, the FTC and DOJ never get to say "yea" or "nay," they have to go to a court and convince a judge or jury. He suggested that some kind of durable guidelines could constrain decision makers and be a good substitute for what we currently have to do in court.

Mr. Werden asked whether the conduct being challenged under Article 82 can be the very thing that created the firm's market power. Mr. de la Mano responded that dominance is a necessary requirement, but noted that in considering dominance, the EC assesses what the market looks like without the act. He added that if dominance acts as a screen, we have to be careful not to set the standard for dominance too high. He suggested that all the panelists would agree that the difference between a company with a slightly higher than 40% market share and a slightly lower than 40% market share really does not matter. However, in the EC, he explained, a firm with a 35% market share will not be found dominant, but a firm with a 40% market share would–and it is this difference that determines whether the Commission will intervene.

Mr. Stelzer asked Mr. de la Mano to explain whether the EC would view a complaint originating from a competitor as somehow tainted. Mr. de la Mano said that the Commission would consider the private interests of the complainant, but ultimately the Commission is obligated to determine whether to accept or reject the complaint.

Mr. Werden then asked Mr. Krattenmaker whether the mere exercise of exclusionary market power is always a violation of Section 2. Mr. Krattenmaker asked whether he meant this to mean in the absence of maintaining market power. He suggested that the whole point of the competitive process is to beat your rivals.

Mr. Werden asked whether, if we do not demand that conduct has at least a high likelihood of creating durable market power, we run the risk of doing more harm than good. Mr. Stelzer asked what Mr. Werden meant by "durable." Mr. Werden responded that he meant something more than temporary. He also asked whether, in predatory pricing, the plaintiff should have to show pricing below costs. Mr. Stelzer said that measuring costs is impossible. He suggested that the real question is whether this kind of practice is entry deterring, not whether the firm prices below or at cost and has prospect of recoupment. He noted that we live in an age in which funding of new firms is done by venture capitalists. The first thing the venture capitalists want to know is the range of practices that competitors can do to keep you out of business or to harm your business. Mr. Stelzer said that he would be skeptical of the range of competitive tools available to incumbents.

Mr. Werden asked whether it is problematic for an incumbent, currently pricing at $100, to lower its price to $80 when a new firm enters. Mr. Stelzer said that you cannot just look at one thing–here, price–to determine if this conduct violates Section 2. He said that we have to look at the entire range of business practices available to the company, including the durability of the competition and whether the firm is imposing inefficiencies on its competitors. Mr. Krattenmaker suggested that some would say that a firm lowering its price to drive out competition is efficient.

Mr. Stelzer commented on a remark made by Mr. Sims earlier in the discussion about Section 2 cases being fact-driven. Mr. Stelzer noted that although there are some cases that are fact driven, many recent cases are based on theory: *Aspen Sking*, *Weyerhaeuser*, and others. Mr. Sims responded that he disagreed with Mr. Stelzer's assessment, particularly of *Aspen Sking*.

Mr. Werden then asked whether *Brooke Group*-type rules could add clarity to our analysis under Section 2. Mr. Sims said that *Microsoft* might stand for the rule that adding new products is acceptable, even if they add competitive harm. He also noted that he would accept a *Brooke Group*-type safe harbor for new product introductions, but indicated that he doubted that the panelists would be able to reach consensus on that issue. Mr. Stelzer asked Mr. Sims whether he would extend a safe harbor to "fighting brands" in the cigarette industry. Mr. Sims said that he would not have a problem with that, especially in the cigarette industry because it has so many small players. Mr. de la Mano said that no bright line rule will work unless defined very carefully because we cannot know the effect of the new product. He also added that it is difficult for a competition authority to determine whether a product actually is new or just an additional feature to an existing product.

Propositions

Mr. Wales and Mr. Werden then posed propositions to the panelists and asked whether consensus for the propositions exist.

Proposition #1: *Monopoly power is the long-term ability of a firm to earn greater than a competitive return on investment.*

Mr. Werden noted that this is an almost verbatim definition of monopoly power from an economics textbook and focuses attention on whether firms are earning more than a competitive rate of return. Mr. Krattenmaker joked that this definition is "good enough for government work," but noted that he would want to think about whether he would rather consider evidence of competitive returns than costs. Mr. Stelzer asked whether Mr. Krattenmaker would substitute cost of capital for a competitive return. Mr. Stelzer noted that a huge dispute exists over costs of capital, but that cost of capital is a more precise calculation than costs. Mr. Werden noted that the question is in the difference between monopoly and market power–some define market power as price above short run marginal cost. Mr. Krattenmaker added that he believes market power has a durability component. He said that monopoly and market power are both the same quantitatively and qualitatively, but each come in degrees. Mr. Bishop noted that there is some debate in Europe over firms that are dominant and those that are super-dominant. He questioned why we bother with these new terms if we just use dominance as a threshold question to determine whether to challenge the conduct.

Proposition #2: *Monopoly power is rare.*

Mr. de la Mano responded that monopoly power is common, but the real question is how much power a firm may have before the EC investigates further. Mr. Werden noted that showing that a firm is a monopolist in the United States is difficult, but it is easier to show in Europe. Mr. Krattenmaker noted that Mr. de la Mano really put his finger on the issue. Mr. Krattenmaker said that if a firm has monopoly power if it faces a downward sloping demand curve, then most firms will be found to have monopoly power.

Proposition #3: *The* Cellophane Fallacy *likely does not apply in attempt to monopolize cases.*

Mr. Werden noted that the defendant in this case does not start out as dominant, but has a dangerous probability of ending up dominant as a result of the action. Mr. Bishop already addressed this proposition, so in the interest of time, Mr. Werden moved on.

Proposition #4: *When the* Cellophane Fallacy *does apply, the proper benchmark price in market delineation is the market price absent the challenged conduct, which is normally not the competitive price.*

Mr. Bishop noted that, usually, we do not know the "but for" or competitive price as a practical matter. Mr. Werden asked him whether he would agree with this proposition if he could

determine these prices. Mr. Krattenmaker said that we get into a mess when we pretend we can ignore reality. If we know both price absent challenged conduct and the competitive price, he would be inclined to focus on the competitive price because the competitive price is what we are more likely to be able to assess given supply and demand. Mr. Bishop said that no practical difference exists between the competitive price and the price absent the conduct. Mr. de la Mano disagreed with Mr. Krattenmaker from a practical standpoint. He said that it is easier to find cases to show price absent the conduct than to find the competitive price. Mr. Bishop added that either benchmark means that the inferences you can draw from the data are similar and that the practical point of view does not make any difference.

Proposition #5: *A market-share based safe harbor is appropriate in monopoly cases.*

Mr. Bishop agreed with this proposition. Mr. Krattenmaker disagreed because it has a singular noun. He explained that he might be willing to look for a safe harbor for exclusionary conduct, but that the same threshold would not be appropriate for collusion-based Section 2 cases. Mr. Sims indicated that he would be comfortable with a 70-80% market share safe harbor. Mr. Stelzer said that his answer depends on the relevance of the safe harbor–if it is used to determine whether to bring cases, he might agree to a safe harbor, but he would not use a safe harbor as a rule for liability. Mr. de la Mano noted that the EC has a 40% safe harbor rule. Mr. Bishop commented that he would prefer to have threshold at 40% than no threshold at all. Mr. Wales asked Mr. de la Mano for the source of the 40% threshold. Mr. de la Mano responded that the threshold was derived from case law. He noted that the key issue is what is threshold used for–if it is just a first step in the analysis, then having a low threshold is better if the enforcers can be disciplined about having to prove the next steps. Mr. Bishop commented that European courts do not have room for an effects-based system since so much focus is on dominance thresholds. Mr. de la Mano noted that some courts have indicated their willingness to reconsider prior decisions on Article 82 and their openness to see more effects-based analysis on the part of the Commission.

Proposition #6: *"[I]n evaluating monopoly power, it is not market share that counts, but the ability to* maintain *market share."*[3]

Mr. Werden asked whether durability is crucial in a finding of market power. Mr. Krattenmaker agreed with the proposition if it meant durable market power. Mr. Stelzer said that in any case it is easy to find someone to say that monopoly power is not durable–you can fill a courtroom with experts to show how market power is not durable. He cautioned against introducing a test that requires proof that the market power has to be durable. Mr. Sims agreed that it is true that the closer you get to a careful analysis of the facts, the less enforcement you will have. He noted that slogging through facts is difficult, but that is the true result of being wedded to the factual analysis.

---

[3] United States v. Syufy Enters., 903 F.2d 659, 665-66 (9th Cir. 1990).

Conclusion

Mr. Wales and Mr. Werden then adjourned the hearing. The hearing continued the following day with an additional panel on monopoly power.