UNITED STATES FEDERAL TRADE COMMISSION

and

UNITED STATES DEPARTMENT OF JUSTICE

SHERMAN ACT SECTION 2 JOINT HEARING

UNDERSTANDING SINGLE-FIRM BEHAVIOR:

MONOPOLY POWER SESSION

WEDNESDAY, MARCH 7, 2007

HELD AT:

UNITED STATES FEDERAL TRADE COMMISSION

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9:30 A.M. TO 4:30 P.M.

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and

JOEL L. SCHRAG

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Bureau of Economics, Federal Trade Commission

PANELISTS:

Morning Session:

Andrew J. Gavil

Richard J. Gilbert

Michael L. Katz

Philip B. Nelson

Joseph J. Simon

Lawrence J. White

Afternoon Session:

Simon Bishop

Thomas G. Krattenmaker

Miguel de la Mano

Joe Sims

Irwin M. Stelzer

C O N T E N T S

P R O C E E D I N G S

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MR. SCHRAG: Good morning. Sorry about the technical issues. Welcome.

My name is Joel Schrag. I am an economist at the Bureau of Economics here at the Federal Trade Commission, and I am one of the moderators for this panel. My co-moderator, standing next to me, is Dennis Carlton, Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice.

Before we get into the substance of the program, on behalf of the FTC staff who have worked on this session, I would like to take the opportunity to thank all of our colleagues from DOJ for their hard work and their efforts to jointly present this session.

In addition, after today's and tomorrow's hearings on monopoly power, the hearings will next turn to issues involving remedies later this month, and so I urge you all to be sure to check our agencies' respective web sites for updates on these future hearings.

As the FTC representative, I do have just a few housekeeping matters to cover before we begin. First of all, please turn off all of your cell phones,

BlackBerries and other noise-making electronic devices. Second, the restrooms are located out through the double doors and across the lobby. If you need help to find them, there are signs that should guide you.

Third, one safety tip, especially for visitors, in the unlikely event that the building alarms go off, please proceed calmly and quickly as instructed. If we must leave the building, you exit out the New Jersey Avenue doors by the guard station. Please follow the stream of FTC employees to a gathering point across the street and await further instruction, but hopefully that won't be necessary.

Finally, we request that you please not make comments or ask questions during the session. Thank you.

Let me just say a few things about the session. Many of the prior sessions of the hearings addressed particular conduct that's been challenged under Section 2 of the Sherman Act. Today, the hearings turn to issues of monopoly power and market definition, and these issues we believe are very important.

In fact, if you were at the opening day of the hearings back in June, both Herbert Hovenkamp and my co-moderator, Dennis Carlton, were given the opportunity to place the issues for the subsequent hearings in

context. Both identified monopoly power and market definition as areas where there are difficult, uncertain questions that must be addressed in many cases, and I expect that today's panel will help to clarify, if not completely resolve, these difficult questions.

The hearings will be organized as follows: First, we'll hear an approximately 15-minute presentation from each of our six distinguished panelists. We'll probably take a break after the fourth panelist and then come back from the break and hear from the two remaining panelists. After that, the panelists will have an opportunity to comment on each other's presentations, and we'll have a moderated discussion.

So, I think I'd now like to turn things over to my co-moderator, Dennis Carlton, who will introduce our distinguished panelists.

Thank you very much.

DR. CARLTON: Okay, thank you. I am Dennis Carlton. I am a Deputy Assistant Attorney General in the Antitrust Division, and it is a pleasure to welcome all of you to these joint FTC/DOJ hearings.

I had the privilege of participating in the opening session of the hearings, and one of the topics I said that needed clarification was precisely the topic of the panels today and tomorrow, a focus on what we

mean by "market power" and "market definition" in Section 2 cases I think is really important.

I am also a Commissioner on the Antitrust Modernization Commission, and despite my attempting to do so was not able to convince the Commission to study in depth the definition of market power and market definition in Section 2 cases and to report on it. So, that, I think, emphasizes all the more how important this session, this panel discussion, is today, and the real question is, can we reach consensus on any of the hard questions or at least can we reach a consensus that there's a lot of ambiguity and arbitrariness in what is going on?

I am honored to chair such a distinguished panel. All of the members of the panel have extensive experience, both academic and nonacademic, in antitrust and have served both in the private sector and in the government sector.

In the interest of saving time, I am going to introduce them all at once and hopefully by that time the computer will work. So, starting with Phil, Phil Nelson is a principal at Economists, Inc., an economic consulting firm. Previously, he served as the Assistant Director for Competition Analysis at the FTC and as an Adjunct Professor at Fordham Law School. He has written

numerous articles and two books on antitrust topics, and he edited the ABA's antitrust section of market power -- The Market Power Handbook. He currently is the vice-chair of the section's Healthcare and Pharmaceuticals Committee.

Beside Phil is Joe Simons. Joe is a well-known attorney. He's a partner and co-chair of the antitrust group at Paul Weiss. Previous to that, Joe was the chief antitrust enforcer at the Federal Trade Commission, serving as the Director of the Bureau of Competition from June 2001 until August of 2003. He has the interesting characteristic of once being the tenth largest wireless carrier in the country, because I believe he was a trustee and had a lot of wireless licenses, but in addition to that, he has achieved something that's actually quite rare for attorneys to do, and that is he's written an article that economists cite all the time and is associated with critical loss analysis.

Beside Joe, in a missing seat, is Larry White, who I am sure is on his way. Larry is the Arthur Imperatore Professor of Economics at NYU School of Business. He's the Deputy Chair of the Department of Economics. Previously, in the early eighties, Larry served as the Director of the Economic Policy Office in

the Antitrust Division. Larry has written several books and articles, one of which is well-known to antitrust practitioners called The Antitrust Revolution: Economics Competition and Policy. He's currently the editor of The Review of Industrial Organization. Prior to serving at the Justice Department, he did extensive government service both for the Federal Home Loan Bank Board and for the Council of Economic Advisers.

Andy Gavil is a Professor of Law at Howard University where he not only teaches antitrust, but he has also extensively written on antitrust many articles and has a very well-known case book with Bill Kovacic and Jonathan Baker, Antitrust Law in Perspective. He is about to publish or co-author a book called Microsoft and the Globalization of Competition Policy, which I am sure has focused on Section 2 type behavior. He's currently the articles editor of The Antitrust Magazine and serves on the ABA Antitrust Section's Liaison Task Force to the Antitrust Modernization Commission. He is Of counsel to the Sonnenschein Law Firm.

To Andy's left is Rich Gilbert. Rich is a Professor of Economics at the University of California at Berkeley. He served as the Deputy Assistant Attorney General in the Antitrust Division in the mid-nineties, and at that time, he led the effort to write the

Antitrust Guidelines for the Licensing of Intellectual Property. He has written widely on antitrust topics. He is currently the Director of the Competition Policy Center at Berkeley and is associated with the economic consulting firm of COMPASS.

Finally, Mike Katz at the end of the table. Mike is currently the holder of the Sarin Chair in Strategy and Leadership at Berkeley, the Business School, and also holds an appointment in the Economics Department. Mike served as the Deputy Assistant Attorney General in the early 2000s, and he also served as the Chief Economist at the Federal Communications Commission. He's written numerous articles on economics and antitrust and has specialized in many topics, including network industries.

So, with that introduction, I'll turn it over to our first speaker, Phil, and just let me remind the speakers, we're kind of running tight because we started late, so if you could keep to the 15 minutes, that would be good. The organization of this is going to be four speakers will go, 15 minutes, we'll take a 10-minute break, we'll have two more speakers. We will give the speakers a brief opportunity to talk to each other, and then I'll moderate a discussion for about an hour or so.

Thank you.

MR. NELSON: So, we have a -- are we moments away or should I just proceed without slides?

DR. CARLTON: Is the computer still not working?

MR. NELSON: Well, okay, the reason they put me first is the slides that you can't see are really sort of a background deck that gives you the background on market power. The first slide cites the definition of market power that's at the front of the monograph that the ABA published that was referred to earlier, which is market power is the ability of a firm or a group of firms within a market to profitably charge prices above the competitive level for a sustained period of time, and as you can't see on the screen, the word "profitably" is in italics, and so one of the important things in the definition is that a monopolist profit by doing this.

If entry is easy, you may be able to raise prices, but not profitably, because somebody will enter, and if there are a lot of competitors, they can steal customers away from you, so you can't profit. That may become of importance in some of the discussion as to what type of performance evidence one might use in determining whether a firm has market power or not.

A price above the competitive level, the "competitive level" was in italics, because people talk

about the standard monopoly raising prices, and if you are not raising them above the competitive level, usually people don't care.

Then a "sustained period of time" is in the definition because you may be able to opportunistically raise prices for a little bit, but again, entry or something might undermine the ability to do that.

Now, in some of the legal cases, you see reference to the ability to exclude competition, and I will suggest that is something worth consideration, because in some contexts -- and there were FTC hearings many years ago about standard-setting organizations where there might be a collection of, let's say, 10 or more people making a particular product, and there might be enough competitors that they compete and charge a competitive price because there's so many people operating under that standard.

Well, somebody may develop a new technology that would come in and completely take the market away from the incumbent competitors with the older technology. Acting jointly in that case, they might be able to block entry by controlling the standard-setting organization. Are they raising prices above the competitive level? They're excluding an entrant, somebody that would dynamically help the market with a new technology that

might have better performance characteristics and be able to be sold at a lower price. What they get out of it is where their profit is, is that they get to earn the competitive rate of return rather than being maybe in bankruptcy court.

So, while I gave you the standard definition, there are other things and other contexts, as you can see from the get-go, that you have to worry about in deciding whether a firm or a group of firms have market power. And today, largely we'll focus on dominant firms, but there are contexts where a group of firms acting together might have trouble. And if a dominant firm has control over a patent that's a blocking patent that blocks a new technology, he might have an interest in blocking the new technology just like the group of firms that ran the standard-setting organization has an incentive to block technology. So, that's one thing.

The other thing that I wanted to highlight at the beginning is, some people talk about market power; some people talk about monopoly power. Often, economists mean the same thing, but in some contexts, people have defined them differently. Greg Werden is sitting there, and he's drawn a distinction in one of his articles and alludes to other people that distinguish market power and monopoly power perhaps in

terms of the time period over which people have the ability to raise prices and the like.

There are articles out there that talk about antitrust monopoly power, again, trying to make a distinction. And there, often the thought is if you have a differentiated product and thus have a downward-sloping demand curve for your product, you might have some degree of ability to raise prices above costs and you might in that sense have market power, but you might not have a substantial ability to do it. Because there are a lot of products out there that are roughly close substitutes, not exactly the same thing, and you might in that context have some market power but not antitrust monopoly power or antitrust market power, because you don't really have substantial ability to earn substantial profits and the like. So, some people try to distinguish that downward-sloping demand curve idea by talking about antitrust monopoly power.

I think with that background, we're talking about antitrust market power. Something that's somewhat significant. And then different panelists may have different degrees of market power in mind when deciding how you go about measuring whether it is significant enough market power. So, with that sort of definition of market power, the next slide was going to lay out

sort of the touchstones in a typical market power proof that you sort of run through, and the first thing people often define is product market definition. Then they go to defining geographic market definition.

Once you have a relevant product/geographic market combination, often it is standard to look at market concentration in a monopoly case, and once you clear that hurdle and see that maybe it is substantially concentrated or a firm has a dominant market share, a high-level market share, you then start looking at things like entry conditions, other structural characteristics of the market. Maybe you look at in some contexts, you know, the structure of the buyer-side of the market, and if it is a collusion case type of monopoly power issue, maybe you look at the characteristics of the market that make it easier or harder for firms to collude in that market.

Then finally, in a lot of the monopolization cases, you see a consideration of market performance evidence, and that's where you start having things like profit rates of return, profit margins, looking at prices over time or across geographic areas. You look at output patterns and how they vary with prices. And you look at new product introductions. You can either look at them in terms of formal econometric analysis or

often you look at events -- market events that allow you to sort of control for some things -- and look at how if the events give you insights either directly into the market power or at some of the related issues like market definition.

Now, increasingly, because of the success of the Merger Guidelines, you see references to the approach used in the Merger Guidelines of developing a relevant market in the context of monopolization cases, and there were a couple slides that sort of just quoted the Guidelines. I suspect with this audience, there is no reason to go through it, but it is the hypothetical monopolist test. Can the monopolist raise prices above the -- in the Guidelines, they talk more or less about the current level as opposed to the competitive level and see if that's profitable.

Now, one thing that is worth pointing out, especially in transferring that concept, is that in the Guidelines themselves, Section 1.11 says that while you might look at prevailing prices in the Guidelines, there is a caveat that says if pre-merger circumstances are strongly suggestive of coordinated interaction, in that situation, the agency will use a price more reflective of the competitive price. So, there is a caveat in there where they don't always use prevailing prices.

One sort of footnote is that the original guidelines were focused on coordinated effects, and then they later on added more information about unilateral effects. I think there's a little glitch here, because I think the Merger Guidelines actually should make a reference not only to coordinated interaction, but also if the dominant firms raise prices above the competitive level, then you might want to look at the competitive price level.

Why might you want to do that? Well, that is because you get a different elasticity and different substitutes depending on at what price level you measure the substitution. And this is where the lack of slides really hurt us the most, because I put together an illustrative example of a demand curve with a concrete slope and all the rest, calculated the marginal revenue curve from that, showed where the competitive price would be, where basically price equals marginal cost, then showed where the monopolist would operate, which is at a higher price, and then estimated the elasticities of a couple of the different points along the demand curve.

What you see is that even though a demand curve is a straight line and thus the slope is constant over the whole curve, the elasticity changes. And at the

higher prices, the demand is more elastic. And, the reason that that makes sense is that a monopolist is going to keep raising its price, you know, and find a price that is more profitable. And in the monopolistic equilibrium, he has got a high enough price that demand becomes elastic and a further price increase would lose a lot of customers to other products. That is called the Cellophane fallacy -- that sets up the Cellophane fallacy, which is if you measure the elasticities at the monopoly price, you are going to run into problems because there are a lot of substitutes out there that are not substitutes at the competitive price. You can do all the econometrics you want and estimate the elasticities, but if you do not know whether you were at a competitive price or a monopoly price, that elasticity estimate does not tell you anything when you are doing a monopolization case particularly.

So, then you get into this tautological situation. If you think about the paradigm of starting with a monopoly case and saying, "Well, do I have a monopoly here?" And you have to define the market, and you have to define a monopoly price to define the market, then why bother defining the market? So, you have got a couple of issues here that suggest, what do you do about it? And the rest of my deck talks about

the sorts of things that one might look at. But, the basic thing that I wanted to suggest is -- while I think there are great problems with a simplistic analysis of the standard paradigm I outlined -- I think there are elements of it that, if you can go through it all, can help you in many circumstances unravel this thing and cross-check your conclusion.

So, it is a way of organizing your story. Making sure that you look at your story or your analysis as consistent, and that it gives you insights into what you might look at. And where it leads you, I think, is looking more and more at some of the performance evidence. But you have got to be careful in looking at the performance evidence, because as economists have shown, things like profits and accounting data are tricky.

Having said that, I also think that how difficult a problem it is varies a lot from market circumstance to market circumstance. I think it is probably trickiest when you are dealing with consumer-differentiated products, like Cellophane wrapping paper or something. It may be less of a problem when you are dealing with an input into an industrial process, where you can look at substitutes in a more maybe engineering approach type of way.

My time is basically up, so to keep us on schedule, I would recommend -- they are going to post the slides later on, and they are written in a way that they are readable -- so I suggest you look at the slides for the rest of the story.

Thanks.

(Applause.)

DR. CARLTON: Thank you.

Our next speaker is Joe Simons.

MR. SIMONS: Thanks, and good morning, everyone.

I would like to start out by complimenting the FTC and the Department of Justice in holding these hearings and doing a terrific job. I am really quite encouraged that something really valuable will come out of this.

So, one of the first things that happened this morning is the audience was instructed not to ask any questions or make any comments. So, I thought, well, gee, I was planning to hear you violate that restriction right away, but maybe we'll try something a little bit different.

Perhaps by a show of hands, who in here would say that the 1982 Department of Justice Merger Guidelines market definition paradigm was the most significant development in market definition in the last

30 years?

So, we have got most of the panelists and maybe half of the audience. That is pretty good for one thing. I would have expected it might have been a little bit higher.

But in any case, what that showing would demonstrate is an enormous amount of success for that effort, I think by any standard, and why is that the case? Why were those guidelines on the market definition paradigm so successful?

In my view, it is because those guidelines reflected an understanding that the tools of antitrust analysis should be designed for a specific purpose. Previously, you had market definition which was pulled out of the economics literature and it was not designed to do an antitrust analysis. The merger guidelines market definitions was done specifically for that purpose.

The other thing that was really important is that the agency, the DOJ in that case, was willing to be out in front of the case law. I think there was a pretty good argument that those guidelines, the market definition therein, did not really reflect the case law. So, I thought it would be useful to do a little case study and talk about first principles and market

definition.

The Guidelines, the Merger Guidelines, were built around the goals defined right in the Guidelines of preventing mergers from creating or increasing market power -- initially through coordinated interaction and then later unilateral effects. And as I said, they geared this market definition specifically to this overall goal of the Merger Guidelines. So, it was designed to identify that universe of firms that were necessary to profitably engage in coordinated interaction or in unilateral effects. Then for the unilateral effects, arguably the analysis could collapse the market definition into the competitive effects analysis. The market definition in the Guidelines is rigorous, it is logical, and it is transparent.

Now, sitting here today, 25 years later, and seeing what a success this was, you might forget what it was like when these things were first issued. There were hoots and howls from all sectors of the Antitrust Bar and the academic community. These guidelines were ivory tower nonsense; they were completely hypothetical; they were totally inoperable and just downright impractical; a complete waste of time. These were comments that people made very regularly, and some people even said it was a conspiracy to do away with the

antitrust laws.

There was a little bit of a kernel of truth to some of those complaints, not the conspiracy stuff, but to the practicality of this test. There were a lot of people who saw the initial attempts to implement this by the agencies in the following way. One of the staff lawyers would have a conversation with the customers and say, "Gee, do you think that the sellers in this market could profitably raise price 5 or 10 percent?" You are shaking your head, but I heard people do that, Greg, and the customer has no concept of what it takes for it to be profitable. There is no context to the question. So, there were reasonable criticisms.

But what happened is that because the algorithm was rigorous and logical and transparent, it enabled the development of applications basically, tools, to implement this approach, econometric tools. Examples are Baker and Bresnahan and Scheffman and Spiller, Greg Werden as well, something near and dear to me, critical loss. These things did not exist when those guidelines were first issued, and that really was an important lesson to learn, that if you have the right structure, then you have created a platform on which you can build something that really works.

So, what does this translate into in terms of

what we should do for section 2? Well, what are the goals of section 2? What are we trying to accomplish? Is there a consensus? You know, there has been a lot of ink been spilled in relation to the Trinko case, for example. There are differences already between the way the DOJ and the FTC look at this. There is the profit sacrifice test, the no economic sense test; there is the disproportionate harm relative to efficiencies test.

So, where does that leave us for market definition? Does that create a problem? Can we rely on what is in the case law? Reasonable interchangeability, what does that mean? How much interchangeability is reasonable? It is basically relying on cross-elasticities of demand. How high does the cross-elasticity have to be? Is that even something you can look at? Can we rely on the Merger Guidelines market definition? Does the hypothetical monopolist paradigm, as applied in the Merger Guidelines, really work for section 2? And one of the issues in section 2 is, are we focused on the same phenomenon that we are for section 7?

The Merger Guidelines, the Horizontal Merger Guidelines, are basically focused on collusion, an extreme form of which is unilateral behavior. So you are talking about situations in which a group of firms

is trying to restrict their own output, whereas in section 2, what you are dealing with is a situation in which one firm, the large firm, the dominant firm, is trying to restrict the output of somebody else in most cases and maybe sometimes themselves as well. So, what do we do with all of that?

One possible thing to do -- and I am just throwing this out -- would be to come up with a set of goals for section 2, what is the purpose, what are we trying to do, and then work through various scenarios as to what the market definition would be under each of those. So, one potential scenario is, we are going to say that the goal of section 2 is to prevent unilateral conduct that is reasonably likely to significantly raise price or reduce quality. Reasonably significantly, you can come up with other adjectives, number one.

Number two, and you are going to focus on conduct that either, A, has no efficiencies, B, has disproportionately low efficiencies relative to their exclusionary effect, or C, would make no economic sense in the absence of exclusionary effect, and potentially D, permits recoupment of the exclusionary conduct. So, kind of a menu from which to choose.

Well, one could argue that the first condition, that the unilateral conduct be such that it is

reasonably likely to significantly raise price and/or reduce quality, may be a necessary condition. That defines the universe in which something bad can happen. If you do not have that condition, then you might be able to say that nothing bad can really happen. So, you can use market definition in that sense, to focus on that aspect as a screen.

You then could ask, "Well, gee, would the market definition need to change depending on your choice of 2A through D?" And at least at a first cut, I would say probably not, that these factors relate to what might be considered defenses or separate prongs of the analysis. They would not be necessary to worry about in the first market power screen, where you use market power or market definition as the screen.

All right, so what would be the relevant context, then, for measuring profitability of a price increase? Well, obviously the options are before, during or after the execution of the alleged conduct. Well, we are concerned with the price going up as a result of this conduct, so it seems to me you want to focus on whether there might be a significant price increase, whether a significant price increase might be profitable during or after this alleged conduct.

Then similarly, if the conduct is already in

place, so you cannot observe it over time, then the question might be the reverse, which is, absent this conduct, would the price be lower, right?

You see, I think there is the same problem here that you have -- not really a problem, but an issue in the Merger Guidelines -- where for the most part, you are measuring the profitability of a price increase going forward. You are not looking at the current level. You are really looking at a change in the current level that is brought about by the conduct that you are worried about. So, in the merger case, it is the merger; in this case, it would be the alleged exclusionary conduct.

You know, one of the things that is near and dear to me, critical loss, might be a tool to help in this analysis, and it would not be exclusive by any means. Just like in the Merger Guidelines you can use critical loss, you can use all kinds of other estimation techniques, and they are not exclusive.

So, one way to think about this would be that the burden would be on the plaintiff to show the likely extent to which the alleged conduct restrains third-party producers; in other words, whatever the conduct is, exclusive dealing, refusal to deal, whatever, what is the likely impact on third-party

producers? How much restraint does this have on their ability to supply the market?

Then the plaintiff would have to show that it would be profitable for the monopolist to raise price significantly -- whatever the number is, 5, 10 percent, whatever -- as a result of that exclusionary conduct. You could calculate a critical loss for the monopolist that would be based on margins, and you could estimate whether a 10 percent price increase after or during the alleged conduct would leave sufficient residual supply such that a monopolist would lose in excess of the critical loss. So, that would get you the market definition part of this. Then what do you do?

One strategy would be to not even bother with shares, because you have basically concluded that the single firm was able to engage in this alleged conduct and get the price up, and in terms of that, one could say, "Well, that's what we needed to know," and we will now we go through the rest of the analysis and determine what are the efficiencies, and maybe you want to talk about recoupment as well. So, one could reasonably say, "Well, we don't really need a market share threshold." Other people could say, "Well, gee, it is in the case law. We want to try to make it consistent. It is really important. So, we need a market share

threshold." How would that work?

Well, one way to think about it in the context that I have just outlined would be you could say, "Well, the firms in the market would be obviously the alleged predator, and then potentially also other firms that have also benefitted from a price increase as a result of this exclusionary conduct," and you might base their share calculations on their sales of that product for which the price increase was experienced.

But then you ask the question, "Well, why have a share requirement? What does that do for you?" You might say, "Well, it gives us some comfort because predatory conduct is only likely to occur where the shares are high." Well, there is an issue about that, because some exclusionary conduct is really cheap, and some exclusionary conduct is really expensive. So, if you are going to engage in really expensive exclusionary conduct, yes, then you probably want to have a big share, because you need to recover that expense that you laid out to execute the exclusionary conduct, but if you are executing really cheap exclusion involving, a Hatch-Waxman type of scenario or something like that, which costs virtually nothing, well, then, what does the market share do for you? So, that is unclear.

I have got about 30 seconds left, and I just

wanted to sum up by saying I think there are some really important lessons to be learned from the Horizontal Merger Guidelines market definition, and I am hopeful that what will come out of this is we will get a bunch of smart people in a room, maybe Greg and some of his colleagues from the Antitrust Division and the FTC will sit in a room, take all of this together, and come out with an algorithm that is of similar significance to what they did with the Merger Guidelines -- use the first principles integrated approach, not worry about the fact that what they might come out with is a theoretic framework, theoretic algorithm that is not immediately implementable, and then not be afraid to consider a market definition guideline that deviates from traditional case law, because what happened with the Merger Guidelines is people originally said, "Oh, this is nothing like the original case law," and now we have been able to bring the two together, and the courts have seemed to have adopted what is in the Guidelines.

Thanks very much.

(Applause.)

DR. CARLTON: Thank you, Joe.

Our next speaker is Larry White, who has arrived in time. You have already been introduced, Larry.

DR. WHITE: Well, thank you.

DR. CARLTON: And the ground rules are we are running a little late, so if you could keep to 15 minutes.

DR. WHITE: Right.

DR. CARLTON: Does the computer work?

UNIDENTIFIED SPEAKER: Yes.

DR. CARLTON: And you are the first person who has the use of the computer.

DR. WHITE: All right, great. Well, thank you. I am very pleased to be here this morning, and sorry for the delay of my arrival. I flew down from New York this morning, and every once in a while you get hit with a -- I do not know whether it is the right-hand tale or left-hand tale on variance, but we were an hour late taking off. So, here I am. I am very pleased to be here.

I think this is a terrifically important issue, and it is an issue where unfortunately too many mistakes have been made, too many mistakes continue to be made, and I want to walk you through what I consider to be some important issues. I have got a few call it partial answers. I do not have the complete answer. At the end, I am going to be echoing Joe Simons' call. We need a new paradigm; a paradigm is missing.

So, like any good business school professor, I

am going to tell you what I am going to say, and then I am going to say it, and then I am going to tell you what I said. I will frame the issue, I will remind you what the standard monopoly model looks like, I will remind you what the implications of that model are, I will point out the loose language that has been used by people who do know better or who ought to know better, and I'll tell you about the danger of that loose language. That will bring me to the Cellophane fallacy. Everybody is going to talk -- you cannot not talk about the Cellophane fallacy when we're addressing this topic, remind you of an ongoing dilemma, put out some partial suggestions, and wrap it up.

What's the issue? I am not going to get into this market power versus monopoly power. The way I was taught, it is all the same thing, and the exercise of this thing, call it monopoly power or market power, is the seller can sell at prices above marginal cost and earn rents, and I should have added for a sustained period of time, but I will go ahead with my story. That is the picture that we carry around in our head of what monopoly power, market power, is about, the sustained charging of a price above marginal cost, maintaining -- I am going to use that word over and over again -- maintaining a price substantially above marginal cost.

All right, now, what also gets talked about, especially in an antitrust context, is actions -- exclusionary, predatory actions -- that can create or enhance market power. So, somebody who did not have it, can create it. Somebody who has it through an exclusionary or predatory action can enhance it, make the demand curve yet less elastic or inelastic and earn even higher rents.

If the seller is engaging in this kind of activity, whether he is exercising the market power or enhancing, a likely precondition is that the seller has a large share of its market. So, that is not necessary. You can come up with examples where if the overall supply is limited, where other suppliers cannot expand their output very much, where demand is quite inelastic, even somebody with a relatively small share of a commodity market by his unilateral actions can affect the price, but more generally, a large share of something called a market is going to be necessary. But that then raises this threshold or safe harbor issue, what is the market, and there is no standard paradigm for that determination.

So, this is the picture we carry around in our head, and the implications of that picture, the monopolist maintains its price at a level above the

competitive price. He would not want to raise his price any further unless demand changed or costs changed. He is already where he wants to be. In trying to raise his price, he would lose too many customers to sellers of something else, and, of course, if the market changes from a competitive structure to a monopoly -- because of cartelization, because of exclusion -- then the price changes, then the price increases, the seller, newly feeling this market power, raises the price from the competitive to the noncompetitive monopoly level, but as a characterization of what is going on when we take a snapshot of the market, he is maintaining the price at a level above the competitive level. That is clear in this standard model.

About 40 years ago, George Stigler developed an expanded version of this, the dominant firm and the inverted price umbrella, where he described a firm that was not strictly a monopolist, he faced a reactive fringe of smaller firms that were limited in their supply response, and he showed basically you get a similar type of outcome. The dominant firm is able to charge, maintain a price above competitive levels, but he doesn't want to go any higher because -- and there, in the Stigler model, it is implicit -- he would lose too many sales to that competitive fringe.

Okay, why am I making such a big deal out of this? Because there has been loose language out there, first by my colleagues, all of whom do know better, and they describe the phenomenon of monopoly power, market power, in terms of the ability of the firm to raise prices. In other words, I have put in italics over and over again, this language of "raise prices," or in the context of the Microsoft case, Fisher and Rubinfeld making this claim that, "Gee, Microsoft could have raised its price substantially and wouldn't have lost customers," and you have got to scratch your head, how come they didn't? Then Evans and Schmalensee on the other side, again, talking the language of "raise."

Even earlier, as I walked in the door, I heard Phil Nelson talking about the monopolist "raising" the price. Maintaining is what we're talking about, but I am sure I in my looser moments fall into this "raising." It is an easy thing to do, but I am going to show you the dangers of it in just a minute.

I'll go over to some noted legal cases and legal opinions, and again, you have got the same -- oh, did I -- no, I forgot to put the italics in there, but you can see the word "raise" in each of those -- in each of those quotations from those cases.

All right, what is the danger? The danger in

the "raise" terminology is that if we think market power and monopoly power are the ability to raise the price, then it is easy to then think, "Ah, well, the test of whether somebody has market power or not is whether the seller can raise prices above currently observed levels." Remember, that is what Fisher and Rubinfeld were talking about there.

Conversely, if the seller is constrained from raising prices because of its fears of losing too many customers, then does that imply that it does not have market power? The trouble is, even in the standard paradigm where the monopolist is maintaining a price above competitive levels, it cannot profitably raise its price because it would lose too many customers to sellers of something else.

That, of course, then leads us to the Cellophane fallacy, the U.S. v. Dupont case, where the issue was, was the market a narrow market of cellophane, in which case it is clear, Dupont had market power. There was one other seller of cellophane, Sylvania. It was under license from Dupont, and so, effectively, no question. If the market was cellophane, Dupont had market power. Or was it, as Dupont claimed, flexible wrapping materials, in which case Dupont only had a 17.9 percent share and didn't have market power?

The Supreme Court majority said it was interchangeability that carried the day, that cellophane was interchangeable with other materials mentioned -- there was wax paper and brown wrapping paper and aluminum foil and glassine and lots of other things -- and the majority said, "Ah, look, it is interchangeable. Dupont can't raise its price. So, it must be part of that larger market."

The minority pointed out the fallacy of that reasoning and also pointed out the comparison with rayon, where Dupont also faced 15 to 18 other producers, also had a market share that was below 20 percent, and made much less profits. They also pointed out that Dupont's price of cellophane did not move around when those other flexible materials' prices changed.

So, we have this ongoing dilemma. Profit data nowadays are relied on a whole lot less than was the case back in the fifties when Stocking and Mueller were writing, when the Supreme Court minority relied on those profit data. The Horizontal Merger Guidelines cannot be used, because they are a forward look, as you have heard already, they are a forward-looking test.

The one exception, which Greg Werden has pointed out, is that if we are talking about a practice that is not yet in place, say an exclusive dealing plan that is

going to be put in place. A plaintiff comes in, asks for an injunction. We are talking about something where it is a prospective practice. Then the prospective, forward-looking paradigm of the Merger Guidelines will work. To the extent that that is what we are looking at, fine, we have got an answer, but lots of instances are not of that kind.

As Phil remarked earlier, elasticities do not help us very much. You cannot tell the difference between a true monopolist and just a different -- a seller of a differentiated product, a Chamberlin/Robinson monopolistic competitor.

Okay, what to do? Well, sometimes a complaint will involve a prospective practice, and then we have got the Merger Guidelines. Sometimes there will be cross-sectional or time-series evidence involving prices where we can tell that concentration matters, and when concentration matters, you have got a market, and retail services are an area where cross-sectional data may be available.

I harken back now ten years to the Staples case, where cross-section data showed that prices were different, higher where only Staples or Office Depot was present in the market, lower when both were there, yet lower when they and a third office superstore were

there. That evidence carried the day, and I think correctly, that there was a problem -- there would be a problem if the two firms merged, and it told us office superstores were a market.

Think of the American Airlines predatory behavior case. Why do we think that city pairs are a market, city pairs airline transportation? Because there is lots of cross-sectional evidence that shows that, controlling for other things, prices matter and prices are related to concentration. Sometimes profit data will be useful.

I mean, if you think the Microsoft case was a good case, if you thought that Microsoft's behavior was a problem, why did you think that? And I think at least part of the story was those profits. They were so large that even with all the problems that we know about profits, they were telling us something. But what if none of these possibilities are available?

Well, Phil Nelson and I a few years ago made a proposal. It turns out similar language can be found in a 20-year-old article by Tom Krattenmaker. Greg had a version of this proposal in an article he wrote in 2000, where basically it is asking in the presence of an allegation of exclusion, what would have been the consequences of the absence of exclusion? It requires a

two-step investigation.

First you have got to ask, in the absence of exclusion, what would the plaintiff's sales have been? And then you have got to ask, what would the price consequences of those additional sales have been as well?

Now, as was indicated earlier, this would focus directly on effect, and it implicitly delineates a market, but if you think about what the unilateral effects analysis under the Horizontal Merger Guidelines does, it is basically doing the same thing. It is looking for an effect, and then, if somebody goes ahead and then tries to delineate a market, that is sort of redundant. You have already found the effect. Implicitly, you have said there must be a market there, and that is basically what the Nelson and White proposal does as well.

But I think the best approach would be let's try to develop -- you know, I have thought hard about it. The best I could come up with was this joint proposal with Phil. It may not be good enough. Can the world come up -- can the Division, can the FTC, can a bunch of smart people out there -- come up with a paradigm that will have the power and eventual universality of the Horizontal Merger Guidelines?

I urge you, remember what the world looked like before 1982. Remember what 1981, 1980 and 1979 looked like. We did not have a paradigm. We had Elzinga-Hogarty. We had Ira Horowitz's suggestion. There were other ideas out there. George Hay was going around talking about how the Division defined markets, and he would say, "Well, we would look for whether there was a specialized trade journal that the sellers in a marketplace all submitted their data to." Those were the kinds of indicia that people looked to. The Merger Guidelines brushed all that stuff away, and we have now got a powerful paradigm. I hope that some smart people out there somewhere will be able to develop something with similar power.

So, winding up, we have got an unsatisfactory state for market definition. I would hope we are in 1981, and next year, somebody is going to come up with something that will have the same kind of power as the Horizontal Merger Guidelines. I have shown you some partial remedies, but the best remedy would be a new paradigm.

Thank you very much. I am very pleased to have this opportunity today.

(Applause.)

DR. CARLTON: Okay, thank you, Larry.

Our next speaker is Andy Gavil.

DR. GAVIL: Good morning, everyone. Thank you to the organizers for inviting me to join everyone today. I am delighted to be here and agree with everyone else that these are some very important -- indeed, fundamental -- issues to how we go about analyzing antitrust cases, and in truth, they are not at all unique to section 2. Questions of power and effects really cut across all kinds of cases today. So, resolving one area clearly is going to influence and affect the others just as the Merger Guidelines has affected many areas.

So, I start with my first slide in talking about it is all about anticompetitive effects, and I think I would add to that, and legal process. At the end of the day -- that is a great phrase, "At the end of the day" -- "At the end of the day, in the final analysis" -- but at the end of the day, in the final analysis, whatever we conclude as a matter of economics is the right approach, we have to translate that into a legal system of decision-making. It has to work in courts. It has to work in a context where we have burdens of pleading and burdens of production and burdens of proof. It has to work in a context where we have various methods for discovery of evidence, where we

have a role for expert witnesses, where we have judges and juries, and if it cannot work in that context, then perhaps there is a problem with what we have come up with as a theoretical matter.

I forget who it was, I think it was Joe talking earlier about how the Merger Guidelines were originally received. Well, part of the problem in how they were received is that they were received by a legal community accustomed to looking at cases in one particular way. They suggested that we needed to look at those cases in a very different way, and it was very unclear in 1982 how you would translate, how you would take something like SSNIP and what evidence would you need?

The lawyers that were asking the questions of, what witness am I going to need to do this? What evidence will I need from my client, from the other parties? How will I assemble it? How will I present it? There can be no doubt at all I think in anybody's mind that the Merger Guidelines and subsequent developments have been an economist's full employment act, and certainly that has been evidenced in the antitrust area. It is hard to imagine today proving any kind of case, plaintiff or defense, without the role of economists, and that is a result of the writing into our substantive standards various economic ideas.

So, as I go through these slides, I want you to sort of keep that in mind. The focus I have tried to bring to my comments today is, how do we make it work in this legal system? Well, common issues in antitrust are effects, and we have certain ways that we go about establishing them. We have irrebuttable presumptions -- that is what the per se rule is all about -- and we have rebuttable presumptions; whether we are using direct evidence or circumstantial evidence -- and that is going to be an important issue that I am going to look at today -- we have different ways that we go about trying to establish effects.

Direct evidence, defined here, is the actual exercise of market power. It may come out in performance evidence. It may come out in before and after studies of price. It is reflected to some degree in our use of "quick look." The "inherently suspect" formulation is also a way of looking at things that are obvious, and a question I will be asking today is, do we have equivalents for section 2 and would it make sense to use them in section 2?

On the circumstantial evidence side, we have something that I have called a "double inference." We define a market, we calculate market shares from a certain level of market share, we infer market power,

and in truth, from that, we then infer the capacity for anticompetitive effect. In litigating terms, we are dealing with two very standard paradigms of how to go about proving something.

Well, power, of course, is a condition precedent of effects, but if you look in the cases, there is a lot of confusion -- again, loose language -- about how it is used. Some cases say, "Well, what we need is market power," and even in cases like NCAA and Indiana Federation of Dentists that really were out in the forefront in this quick look idea and the use of direct evidence of actual effects, there is confusing language about what "market power" means.

Well, power is the condition precedent of effects. If you have the effects, the power is there. So, part of the point of Indiana Federation, talking about market definition and market power as surrogates, was to make the point that when you have the actual effects evidence, going sort of back around the circumstantial evidence route, trying to define a market and determine whether there are large market shares, may be beside the point. Those things are surrogates for direct evidence.

Well, as in many areas of antitrust, that leads us to a point where we can identify easy cases and hard

cases. A good example I think of the easy cases, when the direct and circumstantial evidence are aligned, when they are pointing in the same direction, when you have evidence of actual effects and you have high market shares, those are easy cases. We do not argue about those very much. The D.C. Circuit in Microsoft actually structured its discussion of monopoly power that way, looking at both direct evidence, circumstantial evidence, they are both pointing in the same direction, easy case.

On the other hand, for safe harbor ideas, if you have de minimus evidence and no effects and you have low market shares, again, pointing in the same direction, and I would make this point -- I'll raise it a little bit later -- in terms of safe harbors, I do not think you can rely just on market shares alone. It has to be market shares plus certain other factors, and I will also suggest that if we are going to have safe harbors, we need some danger zones, and again, it might be market share plus some other characteristics.

But evidence and power effects are interrelated, and I think this is what makes part of our current framework very difficult to think about. Courts do think, because of years and years of case law, first monopoly power, then willful acquisition or maintenance,

when in truth, the evidence of conduct and effects in the evidence of power is going to be very interrelated.

Well, again, thinking about direct and circumstantial evidence, the benchmark for circumstantial evidence is clearly the Horizontal Merger Guidelines. They really did advance the science of thinking in terms of circumstantial evidence. Recall, though, that Cellophane was a section 2 case, and maybe there are some different problems that come up when we are doing prospective predictions about likely market power versus retrospective methods when we have, you know, the before and after ability to actually look at the effect of conducts, but the Merger Guidelines in any paradigm we come up with are probably going to have some continuing significance. They have been cited by courts outside of section 7. They are cited in section 1 cases and section 2 cases. Basic ideas and concepts are clearly interrelated.

So, my suggestion at this stage of our development is we need something of a similar to the Merger Guidelines to refine "actual exercise" standards and to harmonize those standards across different offenses. A critical question, I think, is how much and what kinds of effects evidence should be sufficient to shift a burden? And here I remind, again, that outside

the area of exercising prosecutorial discretion, outside the walls of the agencies when they are deciding whether to bring a case, if the decision to bring a case is made and the economists agree, the next question the lawyers are going to have is, "Well, how do we meet our burden of production? What evidence are we going to assemble? What is going to make us win this case?"

I think when you are thinking about direct effects evidence, and market share as well, a critical question in section 2 is, what does it take to shift a burden? Frequently what you see defendants arguing in cases is the burden didn't shift, the burden didn't shift, the burden didn't shift. Well, what does that mean?

It means that there is no requirement on the part of the defendants to actually justify their conduct. If they claim there are efficiencies, where is the evidence of efficiencies? That does not happen until the burden shift takes place. That is a critical stage. It is a critical stage that has to be focused on, and I have given some examples here of various cases that raise some of those questions.

I think we are also feeling the weight of the Alcoa paradigm. In looking back at Alcoa and the cases that preceded it, all Judge Hand did was he surveyed the

previous cases and looked at winners and losers to come up with his three famous sort of -- you know, 33, not enough; 66, maybe; over 90, definitely. Well, where did he get that from?

If you look at the prior Supreme Court cases, you will see that there were cases falling into each of those categories. He sort of synthesized them and came up with this benchmark. I think an important question for us is, are we ready to move beyond the total reliance on market shares, which sends us off in this direction of conflicting evidence, plaintiffs and defendants having experts -- the market is big, the market is small -- and is that really where we want to be? What can the role of direct evidence be?

The Re/Max case was an example of a court relying on direct evidence, actual price effects evidence in a section 2 case. The 7th Circuit in Republic Tobacco rejected such an approach, said that Indiana Federation did not apply and NCAA did not apply to a vertical case. Is Staples -- and the unilateral effects that people have alluded to already -- is it related? I think it is. It is a way of trying to more directly gauge. We have talked about the monopoly versus market power being kind of a silly distinction. So, I will move on.

I think there is an important role here for decision theory, which obviously has begun to influence our thinking. The emphasis tends to be on fear of error costs, and often that motivates calls for more and better evidence. We need more before that burden shifts. One point I would like to walk away with today is urging that we also consider the second half of decision theory, which is process and information costs. Is more evidence really always better?

In that regard, I sort of suggest -- and it is not really new, there is a lot of general literature out there on the economics of evidence. Richard Posner has a long article on an economic analysis of evidence, and I put forward the question, "When does the marginal value of additional evidence in terms of economic certainty (minimizing error costs) outweigh the costs of obtaining and processing that evidence, taking into account whether it is reasonably accessible to the party bearing the risk of non-persuasion?" What I tried to do in that question is integrate some economic ideas and some legal process ideas from both the rules of procedure and the rules of evidence. It is always easy to demand more. It is always easy to pursue some kind of level of absolute certainty and minimal error costs. The question is, as a legal standard, when we take that

into court, is that really going to strike the right balance for us in resolving cases?

Antitrust is not always rocket science, and I think we need to get over the idea that it always is. Yes, we need safe harbors to guard against false positives. I think we also should be emphasizing equally defining danger zones where we might be running into false negatives.

Is monopoly power all that puzzling? I would point out to everyone that neither 3M nor U.S. Tobacco, in two U.S. Courts of Appeals monopolization cases, even contested that they had monopoly power. In the Microsoft case, they contested it, but rather unpersuasively, and every agency and every court to look at it has concluded that yes, indeed, Microsoft had monopoly power.

We could go on with a couple other examples, American Airlines, Dentsply. Were these really such difficult cases? If they were not, then why were they so difficult? Why would parties not even litigate the point about their power? There must be, there must be cases where -- again, market share plus -- where there must be additional factors, information on entry barriers. Entry barriers will always, for example, be important.

Finally on this slide, sliding scales, not all burden shifts are created equally. You see this in cases like Baker Hughes and Heinz in the merger area, the realization that sometimes when a burden shifts, it really shifts, and the presumption is very strong, and other times, it kind of is just enough to shift. Well, in responding to those sorts of cases, we might want to respond in different ways by considering what is required to shift and what is required to shift back a burden in different ways.

On legal standards and decision-making, I think that the balancing of effects idea is a straw man. We could cite, as Larry White did, we could put up lots of slides with courts saying, "Anticompetitive effects; the burden shifts. Efficiencies; then we balance one against the other." We do not really do that. I have looked; you can all look. If you can find me a Section 1 litigated case in which the case was actually decided on balancing effects versus efficiency effects, consumer surplus diminution versus increased producer surplus, find me such a case. I would like to see it. It is not what we do.

What we do is weigh evidence. What juries do is they compare the evidence of anticompetitive effects with the evidence of efficiencies, and they make a

decision about where the weight of the evidence is. That has to do with credibility; it has to do with persuasiveness. It does not have to do with $10 of anticompetitive effect and $11 of efficiency.

Finally, a word about caricatures and corrosion of the rule of law. The level of discourse and the level of criticism of antitrust, as we all know, has continued for quite some time. It has continued despite the fact that in the last 40 years, we have seen some pretty major corrections to antitrust.

I say caricature -- and this is not my caricature -- but this is what you see in a lot of the criticisms of antitrust, and I think it is a caricature that ignores this last period of adjustment over the last 30 years. Incompetence -- judges, just incompetent. They can do habeus corpus, they can do environmental, they can do securities law, but antitrust is rocket science, keep them away.

The same thing with juries. They just do not know the difference between somebody who is full of it and somebody who really knows what they are doing. They cannot tell the difference between economists in this case and, of course, neither can they decide any other possible case.

And, of course, enforcers. I have the asterisk

there just to remind me to say that. Typically it is enforcers themselves who make this argument, God, we are so stupid. You shouldn't really trust us to make any decisions, and although we may -- and it gets very personal -- we may be able to make the decision, but other enforcers are really stupid, especially those guys at the offices of the states.

Who are the untrustworthy self-interesteds, the self-interesteds who are untrustworthy? Rivals, oh, they are always full of it. They are always complaining about more competition. Dealers, yeah, what's that freedom of dealer stuff? You know, manufacturers, consumers, aligned; dealers, out in left field. And plaintiffs pretty much all are full of it, especially class action reps.

Ah, but who can we trust? Dominant firms. Dominant firms articulating efficiencies. Fear of error cost? That's truth. We need to put a lot of weight in that. We need to be concerned about it. Other defendants, generally yeah, and especially efficiencies.

Two problems I have with this sort of caricaturing of antitrust. One is, I don't think it is true. I would like to see the list of false positives in the last 25 years. We have been moving towards reduced error costs, and here I think it would be

helpful to have the economists really define what they mean as "false positive." It is not a case on which reasonable people can differ. It is a case that sort of -- again, borrowing from procedure -- no reasonable party could have come out that way. To me, that would be a false positive or a false negative. It is not a case that we simply disagree about.

LePage's has, you know, been frequently used as sort of this example of a false positive. Be reminded that 3M did not contest its market power, and if it did offer any evidence of efficiencies, nobody who looked at it found it very convincing. Did the Court of Appeals give us a useful standard for bundled pricing? No, but neither has anybody else yet. So, to call that a false positive and say, "This is an example of how we're going to inhibit all kinds of other cases," I am not sure that that is justified.

The final point and I will sit down. As I said at the start, Larry said at the end, you say what you said at the beginning. At the end of the day, these cases have to go to court sometimes, and this kind of rhetoric of criticism ultimately is corrosive of the rule of law. I think it is heard in curious ways outside the United States. These criticisms really go to the heart of whether we are willing, at the end of

the day, to rely on courts to make decisions.

We have numerous procedural devices, summary judgment, judgment as a matter of law, Daubert standards, appeal rights. If after all of that has occurred a plaintiff actually wins a case, which does not happen very often, I think we ought to be a little bit more cautious about tossing the rhetoric around about the incompetence and the untrustworthy self-interesteds, all right?

Thanks very much.

(Applause.)

DR. CARLTON: Thank you very much, Andy. I was pleased to hear I am not as incompetent as once enforcers were thought to be, and to prove that I am still competent, we are going to have a break, and it will be a 10-minute break, and we will reconvene promptly so that we can try and stay roughly on schedule. Thank you.

(A brief recess was taken.)

DR. CARLTON: Why don't we try and start. Our next speaker is Rich Gilbert.

DR. GILBERT: I would like to thank the organizers for the opportunity to be here. I was invited to talk about technology markets, so if any ink gets spilled on this issue as a result of my comments,

you can be sure it will be Independent Ink, though I will not talk about the presumption of market power for patents. I thought we resolved that issue in the IP Guidelines, although it is not the case that the Supreme Court immediately adopts everything that the agencies come up with.

Now, when we talk about market definition, there is a real sense in which we are talking about either guide posts or lamp posts. Now, lamp posts, as you know, shed light on a subject but do not necessarily shed truth about the subject. A lamp post might illuminate the ground, but that does not mean that the dollar that we are looking for is around the lamp post, even though if it were, perhaps we could see it.

Guide posts, on the other hand, serve to focus the analysis. The guide posts lead the way. The way may be very foggy and very complicated and very difficult, but can be very useful.

Now, my take, sort of in the spirit of Andy's comments, the courts and defendants like the market definition exercise, even though it is often used much more as a lamp post than a guide post. They like the exercise because, of course, for a defendant, if you can show the market is very broad, chances are there is no antitrust case there. For a court, they are all very

busy. They have full dockets. If you can show the market is very broad, they do not have to worry about it.

Plaintiffs also seem to like market definition or many of them like market definition, because if you can prove that or demonstrate or make a convincing case that the market is narrow, well, chances are then there will be an issue, but as I think everybody on this panel is implying, none of those conditions, whether it is broad or narrow, presumptive of a case or not presumptive of a case, none of them are really relevant directly to the analysis. We would rather have market definition serve as the guide post to lead the way to the right analysis rather than defining whether there is or is not a case.

Now, so, if we talk about markets for technology -- first I should distinguish, I am going to focus more on technology markets than on markets for technology. Markets for technology can be analyzed using conventional goods markets, often using conventional goods markets, which are sufficient for analysis in many high technology industries, whereas technology markets are useful when what is at issue is a right or rights to a technology that are licensed rather than embodied in a patent. So, I am focusing more on

technology markets than markets for technology, although maybe in discussion, we will get to that distinction, whether there should be a distinction.

Technology markets are defined in the IP Guidelines. Technology markets consist of the intellectual property that is licensed that are close substitutes. Of course, here now, as in all market definition exercises, the issue is, what are the close substitutes? And when you are talking about technology markets, the close substitutes are not only other intellectual property rights, but also goods and services that may substitute for those intellectual property rights.

It adds another layer of difficulty and complexity to the analysis, because just like in conventional -- other section 2 goods market definition, exactly what to sweep into that analysis and how, it depends upon the prices, prevailing prices, and whether the conduct is prospective or retrospective, these are all challenging issues, which I am not going to entirely resolve.

Now, technology markets also are -- there is an upstream analysis for inputs which I think raises some interesting questions by itself. Technology markets have been used I think with some success to analyze the

licensing of technology to manufacture float glass, for blending clean gasoline in the UNOCAL case, the float glass with the Pilkington case, for designing fast computer memory chips, as in the DRAM cases, perform laser eye surgery, or to incorporate genetically modified traits into agricultural seeds. These are all some examples, I think, of markets that have been analyzed using basically an upstream analysis for licensed inputs.

Now, on the geographic market side, this is an area where using technology markets in some cases simplifies things. It is fair, I believe, to presume in many cases -- not all, of course -- the geographic scope for technology markets is very wide, because it is not very difficult for a potential licensee to negotiate with even quite distant licensors unless there are legal or regulatory or some other restrictions that prevent the use of licensed technology in different locations, as there was, for example, with the UNOCAL case, but in these other cases, the enforcement agencies I think have correctly concluded that the technology markets are very broad, U.S.-wide and sometimes worldwide.

Now, technology fees, should these be indicators of market power? Interesting question which has not been quite directly addressed. Marginal cost of

licensing is typically very low. It suggests that there is market power if we define market power as the ability to sustain prices above marginal cost, then looking at technology fees, gives you an immediate read on whether or not there is market power, not necessarily monopoly power, but, as economists have said, that is a difficult line to draw between market power and monopoly power.

Now, again, the relevant question is the ability to increase or maintain technology fees significantly above marginal cost for an extended time. In this dispute about market power versus monopoly power, I am certainly in the camp that says that monopoly power is a lot of market power and that there is no clear dividing line between the two, and the question is, the relevant question is, is there conduct that leads to either increasing or maintaining technology fees significantly above marginal cost for an extended period of time and whether it is prospective or retrospective?

If it is prospective, perhaps the ability is to increase technology fees. If it is retrospective, then the question is more has conduct contributed to the ability to maintain technology fees significantly above marginal cost?

This is now more in the spirit of what Larry White was saying in his approach to section 2 market

definition. Also for technology fees, a related and relevant question in a section 2 context is whether competition, whether injecting more competition, would result in a significantly lower technology fee if the competition were not excluded.

I also agree that this opens up a lot of interesting and unresolved issues, as in how much competition should be enough to consider? What should the price effect of that competition be in order to define a relevant market? Is an elasticity of demand faced at the existing prices for the fees and other goods and services? Is an elasticity of demand minus two, is that low enough, small enough in magnitude, or does it have to be minus 1.1 or 1.5 or is minus 3 enough?

These are very important and serious questions that need to be addressed if we are going to do this kind of hypothetical decrease in price through a hypothetical increase in output as a way to identify a relevant market.

So, the focus on that additional competition and whether it lowers the fee I do believe can get around the Cellophane fallacy, and I think another important aspect of that approach is that it focuses the analysis, the definition of the market, on the analysis of the

competitive effects of the conduct. So, I think sometimes it is a criticism of the hypothetical decrease in price approach that it is too related to the conduct that is being alleged as anticompetitive.

I turn it around and say that no, I think it is an advantage of this approach, because it connects the conduct at issue to the analysis of the impacts at issue. Too often, I think many of us would agree that the market definition exercise puts the cart in front of the horse. We should be thinking about where are the competitive effects, how significant can the competitive effects be, and then let the market definition respond to that rather than defining where the competitive effects are. Again, this stems from the problem of the Cellophane fallacy that a profit-maximizing firm has no incentive to raise or lower its technology fee.

Another question about analysis of inputs, in principle, the antitrust analysis for a technology input is not qualitatively different from the analysis of any other upstream good or service. The demand for the input is derived from the demand for the final good or service, and one thing to point out is the Hicks-Marshall Law of derived demand, which says that the elasticity of Derived Demand is proportional to the cost share of the input. It is roughly the cost share

of the input times the elasticity of demand for the output. That will generally lead to a conclusion that the elasticity of demand is pretty small in magnitude.

Indeed, in the Microsoft case, Microsoft made the argument that if you do this calculation, the profit-maximizing price for Windows was I think, like, $1,500 or something like that, and therefore, we could not have market power because we are not charging $1,500. I think it was an argument that was never really entirely responded to, but one does find that as you go upstream, you are going to generally get less elastic demands, derived demands; therefore, more potential to raise prices; therefore, more possibility of competitive effects.

Of course, while it implies relatively inelastic demand for inputs and the ability to affect the input price, the input price has only an indirect effect on the final consumer prices, which is why the elasticity of demand is low. So, it turns around and gets you the other way. So, upstream analysis can overstate the ability to affect consumer prices.

As you move downstream, though, the question is, how far downstream do you go? If you go far enough downstream, almost everything competes with everything else. If you move all the way downstream, eventually

you are competing for the consumer's entire budget allocation, and whether you are talking about movies or sports or buying a car or whatever, everything competes, and the overall elasticity of demand for all goods and services is one, because you only have so much income.

So, it is my view -- my strong view, but it is a view -- that analysis should take place where the firm has the ability and incentive to raise or maintain a price paid for an input or a final good, and the question should be, is the conduct the type of conduct that we want to prevent? And if it is, let's analyze it where the conduct might have an effect and let the market definition follow from where the conduct could have an impact.

I just have a very quick example to end with of genetically modified seeds, which express a desired characteristic, like insect resistance in corn or tolerance of some herbicide. Do conventional seeds compete with licenses for seed traits? So, that gets back to the IP Guidelines definition, where do the goods come in to compete with the traits? It is a complicated question, not one I am here to answer, but I would just point out that these agricultural markets are moving increasingly to genetically modified traits, which is now way above 80 percent in soybeans and up above 50

percent in corn, and if you are looking at questions about whether conduct is maintaining high prices for these characteristics and ultimately higher corn prices, it is my view that you should look at the trait markets for where this conduct is expressed, because that is where the effect could be.

It may be that the conduct is not the type of conduct that should be subject to an antitrust sanction, but that is the right place to look. It goes back to the lamp post and the guide post. Let's look where there could be effects. Let's let the market definition exercise follow from the inquiry into competitive effects. Let's not use market definition as a lamp post to illuminate a problem that may or may not exist.

Thank you.

(Applause.)

DR. CARLTON: Okay, thanks, Rich.

Our last speaker is Michael Katz.

DR. KATZ: I would like to thank the organizers for inviting me here, but I do not have time.

I want to talk about -- it is a bit of a grab bag, but I will start about something systematic, which addresses the question of why delineate relevant markets in a section 2 case, and what I want to start with is really the first principle, what is the point of all

this, and we really try to answer this question of a given practice harms competition and consumers, and what I want to talk about for a few minutes is how that gets us to talking about relevant markets, and I am going to talk about at least three things that relevant markets might be doing to help us answer that question.

Okay, so the first one is you can think of -- what you are trying to do is you are defining relevant markets so you can calculate market shares and concentrations, and we are doing that because we want to know whether the defendant or the firm under investigation, whether the defendant currently has monopoly power. Now, as everyone has been talking about, this is where the hypothetical monopolist test breaks down, so there is an issue there.

It seems to me where we have gotten, actually, in a bunch of the recent cases -- and maybe this also goes to Andy Gavil's point about somebody showing me a false positive -- but I think if you look at Dentsply and Microsoft, there was plenty of expert testimony, but in the end it just came down to hard core pornography, the thing is you know it when you see it. People have a good idea that false teeth are a product and they are not really worried about a lot of other substitutes. I mean, there is sewing your lips shut and things like

that, but I think in both of those, that was not really the issue.

Now, I want to make a couple of other points about concentration as an indicator of market power here. One, if we are going to look at market shares, I think we really ought to ask ourselves, where did the market shares come from? Because it matters. Think about it. In some cases it is because of product differentiation, and some producers have much more successful products that match up with consumer tastes. There can be very different managements of different producers have different strategies, and one of the firms decided to have a high-volume, low-price strategy.

I think the conclusions one would typically want to draw about the implications of them for competition are very different, and so I think it is important to try to have such a theory, and I think it is often lacking in antitrust cases. People just talk about the shares but not what they really mean or where they came from.

The other thing is we want to ask ourselves why we care whether the defendant currently has monopoly power, and I will say at least I think one reason is you can think of it as a one-sided test in a monopoly maintenance case, which is to say, if you are in there

arguing that some particular practice successfully maintained a monopoly and you come up with a credible analysis that says the firm had a very low share, that is likely to undermine the case. Now, it certainly does not work in the other direction, right? Just because you have a high market share does not mean you are guilty of any sort of offense at all and it may be that you got it because you deserve it. Okay, so that is a particular use.

Now, I want to distinguish that from some others, because I think they often get rolled together, and they really are different, although they are related. Okay, so another one that is related is concentration as a screen for potential harm to competition. Now, in a sense what I just said, it is a screen, the one I just said, which is you are saying, look, if they have a tiny market share, is it really plausible that they have harmed competition significantly in the past, but I also want to worry about it going forward, and there it is not at all clear -- in fact, I think it is not a general proposition -- that you want to look at concentrations to understand the potential for harm to competition, because if you are looking at a case on a going-forward basis, sometimes the current share of the defendant is

relevant, but other times, it is not, right? You are not worried about their share now. You are worried about what their share is going to become or what the state of competition will become going forward.

Okay, so, notice I hedged it. I am an economist, so lots of "on the one hands, but on the other hands." So, in some cases where you are looking on a going-forward basis, current shares may be largely irrelevant. In other cases -- and I have the example here of exclusive dealing -- even when you are looking on a going-forward basis, market shares could be relevant, and I would think that would have been true in Dentsply.

Now, as it turns out, in Dentsply, it was looking backwards, but if one had brought the case much earlier, I think what one could have done is say, look, Dentsply has this large market share, and I think by any sensible measure they had a huge market share, and we could argue about the source, but let me just hypothesize here without anyone arguing that it is because they did have teeth that were more popular and more attractive, that there was something about their product that they did have an advantage, and others were not able to imitate, and then you could use that fact to say, okay, that is going to tell us something about how

exclusive dealing is going to work going forward, and even exclusive dealing with at will contracts, which is what was present in Dentsply, because this one firm's products were such a better fit with consumer tastes, that if you have exclusive dealing, that is where the dealers are going to go.

So, in that case, concentration would be relevant as a screen or a way to think about what is going to happen but through a much more complex chain of reasoning than to just say, well, they have a high market share; therefore, they must have market power. It is really a very different kind of analysis, and that is the kind of analysis that I think needs to be done.

Okay, the third one -- and actually, this is the one that is my favorite -- is say, look, we need to identify relevant markets, because if we are talking about harm to competition, we need to have some sense of who the competitors are, and actually, I think that is what the role should be in the merger analysis I will say as well, this really should be about identifying the competitors and then seeing where that takes us in terms of the but-for world, what needs to be the scope of the but-for world, and this is an unfashionable view, because it is low tech and it does not drive you to come up with algorithms, but I think it is important to

remember in the end, this really is what we are trying to do.

We are trying to figure out who are the competitors, because then we can ask, does this practice harm them? And if it does, does that matter for competition and does it matter for consumer welfare? Okay, so again, I think this takes us in a somewhat different direction, and notice, in this one, you may not be worrying about concentration very much directly at all.

Also, since I had promised -- but so far have not done it -- the organizers that I would talk about innovation, let me say a little bit about that. When innovation competition is really significant, and this is not a point that is new to me by any stretch of the imagination, current market shares may not tell us very much, right, the extreme model being Schumpeterian competition, where we see a string of product market monopolies, but the real way competition works in the industry would be that you have firms that come in with major innovations, become the new monopolist, but then there is this battle for the next round of drastic innovation. If you are looking at a market like that, looking at market shares is not going to tell you very much.

Okay, a couple things about market definition and uncertainty. First off, we have talked about burden shifting a little bit. As everyone in this room who works for the Government knows, right, meeting the market definition burden can be difficult, and that is true even if you do not have innovation, and I will come back to innovation in a minute. One of the difficulties is when courts say we want a zero-one boundary. Every firm is either in the market or they are out of the market; none of this wishy-washy stuff.

The problem with that is it can be really hard to do. I know Oracle is a merger case, but it is really striking because it is a case where Judge Walker said, all right, look, here are the economics of why you cannot draw zero-one boundaries. You have got product differentiation. You have got a continuum of products. There is no way there is going to be a sensible boundary. He did not say, "And oh, guess what, that means you lose."

I mean, I think Judge Walker was right about the first part. It is just the notion that that is where it takes you I think is a little troublesome. It is particularly troublesome as well because if you believe that these are differentiated product markets and you believe competition is localized, then you really have

to ask yourself, why are we worrying about a broader market anyway? I mean, what is the relevance of this alleged relevant market if what really matters is defined structure?

So, it seems to me that where we have gone with a lot of -- just to jump back to mergers for a second where I think there is a broader lesson here -- with mergers, is worrying about unilateral effects cases in markets with differentiation -- and everyone seems to have conveniently forgotten that you can have a unilateral effects case with homogenous products -- but we have spent all this time worrying about market definitions in precisely the wrong places.

Now, although this gets worse if you have innovation, because you can have things constantly changing, you can have products -- the characteristics of products are changing, I just want to make two points on this and then move on quickly. One, there are a lot of people who seem to be of the belief that what innovation means is markets are constantly getting broader, okay, and there is a set of people who will say, look, you have got all these things, you have got innovation, markets are always going to be so broad because new products can keep coming in, that really, there is nothing for antitrust to do. I would just like

to remind people that, in fact, markets could be getting narrower, because these products are evolving, they are moving targets, and it is quite possible that some products or the producers of those products are falling behind in terms of innovation and they are dropping out of the relevant market.

Okay, the point I have already made, that if you are looking at differentiated products and then you throw in the complexities of innovation, you just really may make it impossible to meet the burden. As we have talked about, since I think there is a fairly broad consensus, you do not really need to have a rigid market definition. That is unfortunate, but that is how a case would be decided.

Now, I have to have a diagram. So, what this one shows, just very quickly, suppose there is disagreement on the scope of the relevant market here, and I am interested in a case where I will just suppose that one has beaten up on two, okay, these are suppliers markets, and this line represents some notion of product differentiation, and there is a debate. It is hard to know whether the market boundaries are -- the ones who have the narrow subscripts, so only include one and two, or they have the broad, and then they would include producer three as well. Suppose we get the debate down

to that level. This is a dramatic oversimplification.

Well, you can imagine a court, Judge Walker saying, "Look, Government, you cannot tell me whether it is the narrow definition or the broad one with certainty, so you lose." But suppose it does not make any difference whether you include three in the market, okay, to what you think are the competitive effects, then why does it matter that you cannot say which one is which, okay? So, what you really want to ask is not whether or not the plaintiffs can prove a market definition with certainty, but you want to ask can they tell you, "Look, we know well enough where it matters with a high degree of certainty."

So, the approach to this would be to then ask, "Where does the dividing line matter," okay? Go back to this, "Does it matter whether we include five in or not?" If it turns out what is critical in the end is whether three is in the market, let's fight about that. Let's not fight about, no, you have to come up with the definition.

Okay, a quick thing on decision theory. I have a pretty picture, I have to show it. What this is saying is -- I just want to make the following point, I probably will not actually go through the picture, so just admire it while I talk. It was not easy drawing

this on the train while it was jerking around -- but is the following, that there is a lot of focus, I think, in court cases, at least, in actual legal decision-making on doing things like asking are probabilities above certain thresholds or is one probability higher than the other, something like that.

This would be a diagram where if you weigh evidence, you would just ask, is the probability of harm bigger or less than the probability of efficiencies? So, you would get in that red zone, because that's where the probability of harm, P, would be viewed as being higher than the probability of the efficiencies, Q, and you would just sort of -- that is one interpretation of weighing the evidence. There are others, I will note, and if I had a longer time, I would tell you some of the others.

Now, but if you try to balance the effects, you do not just look at the probabilities. You have also got to look at the magnitudes, and I have given the example here where the harms, denoted by H, are bigger than the efficiencies. So, in fact, you want to condemn not just practices where the harm is more likely or equally likely as the efficiencies. You actually want to condemn some where the harm is less likely, but the problem is, well, it is less likely, but when it

happens, it is a worse thing, and that is where you get that purple area.

I would say in the end, since we are worried about effects, the right thing to do, and if we do all this stuff, would be to condemn this bluish-purple area plus the red, but if you simply weigh the evidence, you are only going to get rid of the red. So, you are going to -- if there is enforcement, you are going to have false negatives. So, I think what is important in all of this, and there are many other interpretations of this, but the central point is I think we do have to worry about magnitudes more than we have in the last -- okay, are you going to unplug this? This is like the Academy Awards, they start playing the music.

Innovation, I will say one thing in support of innovation markets as a broad concept, because certainly they have been controversial in terms of actually using them, but if we are worrying about markets where innovation competition is really critical, then we need to worry about what is driving innovation, who the potential innovators are, and looking at markets in a product market may not tell you very much about it. It may be much more informative to look at the distribution of R&D capabilities and assets.

As some people, one of them sitting near me,

have pointed out, that can be really hard, because it may not even be in this industry, but that is conceptually the right thing to do, and so I think we ought to be asking ourselves, how do we get there? If we conclude it is too hard to do, fine, but I don't think it makes sense to say -- and persons near me didn't say this -- "Oh, it is too hard to do; therefore, let's go and do something else that does not make any sense but is easier." I think we want to keep in mind, though, that the R&D capabilities and the distribution of the assets there may be much more important than current market shares in terms of understanding innovation.

Okay, last thing, which does not have anything to do with anything except people always screw it up. I will make what has actually turned out to be a controversial statement in practice, that geographic markets are markets, by which I mean since they are markets, they have buyers and sellers, okay? In practice, at least my experience has been that people often forget about the buyers part of that description of markets, and then if we are going to talk about geographic markets, we need to think about the buyers and where they are and the sellers and where they are.

Now, in some markets, in the end, there may be

global markets and those do not matter, but other times you want to ask something like, particularly in retailing, say, or certain kinds of manufacturing, you would want to say, let's look at a set of customers in a particular city and ask what producers, and in particular the producers' plants, can serve those customers, and look at it that way.

Now, that may mean that a firm is in a lot of different geographic markets, and a single plant, by the way, could be in different geographic markets simultaneously, which drives people crazy, but if you want to think about what is really going on and take markets seriously, you have got to remember, markets are bringing together buyers and sellers, so we need to discuss or describe the locations of both of those.

With that, I will stop.

(Applause.)

DR. CARLTON: Okay, thank you. The person close to you says, "Thank you very much."

Okay, I would like to ask the panelists some questions. We have about 45 questions left, and I have a series of questions. I have about ten questions. I do not know if we will be able to get through them all. What I will do is I will ask the question, and then I will ask two of you to comment. If you could keep your

answers relatively brief, that would be good. If someone on the panel who we have not asked feels they want to comment, they should do so, but since there is an opportunity cost, that just means you may not get to answer a later question.

Here is what it seems to me that the purpose of these hearings are. One, we want to define market power. Can we agree on a definition? If we can, do we think defining the market and then taking market shares helps us in a section case? Then, what are the hard questions where we think that that may or may not help?

Then the ultimate question really is -- and this I will ask everybody to answer, it will be the last question -- do we really need market definition and is it more of a hindrance than a help?

So, let me just start off on first asking the question about market definition. In the legal literature and in the cases, they stress not just the ability to control prices, which is what economists focus on, but they always add, "or the ability to exclude competition," and it is that second prong I want to focus on for a second.

I understand -- and Andy spoke a little bit about this -- that a joint venture can get together and exclude people. Let's just talk about single-firm

behavior, and I am interested, in particular, from both Andy's point of view and Joe's point of view, with their sort of combined economic/legal backgrounds, if they could comment on whether they think the exclusion prong of the market power definition that is used in legal cases is useful. Do we need it? Can we do without it?

For example, can we do without it by saying, "Well, it is the ability to control price, and if you say keeping it above the competitive level, obviously the competitive level is the level that arises when you do not exclude competition." If we can simplify the definition, it seems to me that helps things rather than complicates things. So, is your view that we need that second prong, exclude competition, in the definition of market power or not?

So, let me first ask Andy and then I will ask Joe, and if you could keep your answers sort of relatively brief, that would be good.

DR. GAVIL: I think in exclusion cases, the answer is yes, but it winds up being a first step. The ability to exclude competition -- I guess the "or" is the problem. Why do we have monopolization? We have monopolization cases because we want to prevent not just any exclusion of competition; it is exclusion of competition followed by the ability to either maintain

price, maybe raise price, but the two to me go hand in hand.

In any section 2 case, the first step is going to be evidence of some exclusion, but I do not think you can stop there and conclude from that that there would automatically be monopoly power. You have to ask the second question of whether or not the exclusion will in some way facilitate the maintenance or the enhancement of the market power. So, I think it winds up being circular. You do come back to power over price.

DR. CARLTON: Okay, Joe?

MR. SIMONS: I agree with what Andy said, and also, just to follow up on what Rich said about the guide posts and the lamp posts. You know, what you see in the case law is an example of a lamp post. It is not an example of a guide post. That kind of definition is drawn generally from whatever you guys refer to in the equilibrium analysis or partial equilibrium analysis or whatever it is, and they just moved it over and said, "Here, this is what we are going to do," without thinking about why we really want to do it.

The statute talks about monopoly, so you tend to have to have a big share and so it is natural that a share requirement gets imported into the law. But it does so without thinking, and so I do not think that

focusing on that question based on the case law is going to be terribly helpful.

I think Andy is right, you want to focus on why are we asking this question, what are we trying actually to prevent, what is the goal.

DR. CARLTON: Okay, I think I agree with that. I think probably that is a fair summary of what you said, that I think both of you say we can get rid of that second prong as long as you keep your eye on the ball. In effects cases, obviously you have done something bad, and then did you raise price. So, if you are wanting to define market power alone, it is whether you can raise the price above what it would otherwise be.

MR. NELSON: Or prevent it from falling.

DR. CARLTON: Or prevent it from falling, that is right.

DR. GAVIL: I think the exclusion does tell you something. I would not eliminate it entirely. I think the problem is it does not tell you whether or not you have monopoly power, but it is like the first red flag. It is the first guide post that tells you there may be reason to be concerned about a particular situation, but you cannot stop there. You have to ask the second question.

Even going back to Salop and Krattenmaker, the title of the article was Raising Rivals' Costs to Obtain Power Over Price. So, the two really do go hand in hand, but the first sign of a problem may be the evidence of exclusion.

DR. CARLTON: Right, but what is a mechanism to achieve the control of price? I agree, it is important to have both, but I am just trying to distinguish the two. One of the things that goes on in a section 2 case is you define markets and you have exclusion -- and I will come back to this later -- and the question is how you link the two. I am trying to keep them separate for a second.

MR. SIMONS: I think in what Krattenmaker and Salop do with their article is they are linked. It is the exclusion that gives you the power over the price. What is the impact of the exclusion? Not kind of in a general sense, have you been able to exclude people, all right? Because maybe you have because you have such a terrific product or you have a patent or whatever it is. That is legal. The question then becomes, did you do something in addition to that that may not be so legal, and does that give you power over price?

DR. CARLTON: Right.

DR. GAVIL: Think of instances where the act of

exclusion raises entry barriers.

DR. CARLTON: Yes.

DR. GAVIL: That leads you to the second part of it.

DR. CARLTON: Yes and no. What that tells you is that but for the act, which we are trying to claim is illegal, the price would have been lower, and therefore, you have the power to set price above the but-for price. It is just defining what the but-for price is.

Okay, let me go on, because I am going to come back to this benchmark point. The definition that economists use a lot is that market power is the ability to set price profitably above the competitive level, presumably by a significant amount, for some significant amount of time. So, first, I have two parts to this question, and I am going to ask Phil and Larry.

Assume that there are constant returns to scale, so competition is possible. So, first, do you agree that the definition I gave you is a reasonable one -- put aside whether it is implementable, but is it a reasonable one -- and if so, what is a significant amount of the price increase and what is a significant amount of time?

In particular, when you are answering, if you could talk about why we do not pay attention to dead

weight loss and why we just talk about numbers. I mean, we are economists, and 5 percent, 10 percent, we know that may not be meaningful depending upon the size of the market. So, if you could just address those.

DR. WHITE: Are you looking at me? Look, you know, where do 5 and 10 percent come from? As Bill Baxter used to say, from these (indicating hands), and there's nothing magical about that. You know, it partly would also depend on how much noise you think is out there protecting ourselves against error that might be harmful. So, the real answer -- the first part is yes, under constant returns to scale, a price significantly above marginal cost, sustained for a sustained amount of time, would in my mind constitute an exercise of market power, and how much and for how long, I do not know.

Sure, 10 percent sounds like a number to be thinking about and two years sounds like a number to be thinking about, but I have just picked those out of the air, and I do not have any further basis.

DR. CARLTON: Okay, let me just say one thing. My preference would be it is probably better -- even though it is hard to choose a number, someone is going to choose a number, so you should think, as to your willingness to choose a number, would you rather some random judge choose a number or this panel? So, that is

why I am asking.

DR. KATZ: I mean, I disagree with the premise. Why should you choose a number? I am almost certainly -- if you thought the court was going to do enough of the analysis -- and we would have to talk about the cost of the court and the time they have -- but almost certainly you would say the number depends on the market. I mean, there are some markets where worrying about a price change within 5 or 10 percent, I mean it is completely lost in the noise, because the prices are changing 40 percent every year, so it does not mean a 10 percent price increase could not matter, but it becomes less plausible you could actually tell. In other markets, it might be that you could reliably predict a 3 percent price change.

DR. CARLTON: Following that same logic, wouldn't you be concerned about a 1 percent change in a market that is huge?

DR. KATZ: If you believed you could actually make reliable predictions at that level, yes. So, I think you need to look, as you were saying, at the magnitudes of the effects, and some of it comes within when do you want to bring cases and how to allocate resources and then also the various characteristics of the market that are going to affect the reliability of

your projections and whether you think that you really can discern at those levels, but I think it would be pretty clear that holding aside -- which is obviously a big thing to hold aside -- the various sorts of processing costs, there is no reason to think there is one right number, and, in fact, there certainly isn't.

DR. CARLTON: The question is, should we give any guidance to the courts when they are trying to decide whether a firm has market power, and if you just say it is up to the discretion of the judge based on a lot of things -- I mean, I agree with you, it is hard to come up with one number. The question is, is it better leaving it completely to the discretion of the courts, or should we not -- I think one of the advantages of the Merger Guidelines, even though they make the point that the 5 percent is just a suggestion, is that it has focused thinking and clarified thinking. So, I agree with everything you have said, but in light of the decision-making of the court process, there can be a benefit to articulating some standards, maybe flexible standards.

DR. KATZ: I would agree with that, but I think a question would be -- and this is just thinking off the top of my head -- could you say something like -- have some sort of relatively easily observable data, say like

the annual price changes or something, or try and do something that says that the standard you use should be proportional to some characteristic in the market? We would have to think a lot about what that is, and I think ideally, for the reasons you bring up, it would be something fairly mechanical, but it would still be an improvement over a one-size-fits-all.

DR. CARLTON: Rich?

DR. GILBERT: Well, I certainly agree that the number, however you define this number, depends on the nature of the conduct, the efficiencies that can be presumed to go along with that conduct, and maybe the size of the market and all of that, but I also think there is the case that can be made for shifting the inquiry to something like the firm-specific elasticity of demand, which often can be measured in many instances. I think Greg has pointed this out in some of his writings.

It is not that hard to say if the elasticity of demand is bigger than 10, maybe we shouldn't be worried about this. On the other hand, if it is in the range of 2 to 3, maybe we should be worried about this.

DR. CARLTON: Yeah, that raises a point I am always puzzled about, that if you are thinking about what is a magnitude that is important, an elasticity of,

say, 20, which everybody would say is a really high elasticity, that gives you a 5 percent upcharge over the competitive price. So, that should tell us something about our intuition versus sort of practical --

DR. GILBERT: Well, on that, maybe I am differing from other people, I think of that 5 percent rule as being a derivative, not an absolute amount. So, we ask, if quantity goes down by 5 percent, will the price go up by 5 percent, that sort of thing, and rather than because we are really worried about the price going up by 5 percent. Now, some people I know would disagree with that and would say that that 5 percent is a threshold of concern. I think of it more as an elasticity test.

DR. CARLTON: Okay.

MR. NELSON: Since I was one of the original --

DR. CARLTON: I am going to give you another question, okay? It is actually a harder question now. We are going to move on to something else. That was an easier question. If you remember, that was premised on constant returns to scale. So, it could actually define a competitive price.

Let's suppose now that I am in an industry where there cannot be competition. There is a fixed cost of entry. There are constant returns to scale, and it is

Cournot competition, okay? What is the meaning of that common phrase that we use, can you profitably price above the competitive level? What in the world should we take as the competitive level in that situation? Is it the zero profit equilibrium or is it price equaling marginal cost?

So, let's see, maybe Phil, if you want to take a crack at that.

MR. NELSON: Well, one of the things that sort of concerns me about taking sort of the current level as opposed to something like marginal cost is you do have some of these monopolization cases that are really entrenchment theories, and is the question whether the entry is going to drive you significantly back towards competition, or this guy already has some market power, and he is going to --

DR. CARLTON: Try to define the market equilibrium, free entry, fixed costs, constant returns to scale, Cournot equilibrium, do we want to call that market power?

MR. NELSON: I guess I am saying that to answer that, you want to know sort of what your benchmark is as to where you're going.

DR. CARLTON: Right, that is what I am asking you.

MR. NELSON: Yeah, and what I was going to say is that I think you would start to look, as N goes up, what happens to the equilibrium price? Then as N gets high enough, are you still at a price where somebody could make an economic profit? I mean, you are going to want to see if that is a tenable number of firms and start to use something like that as the equilibrium, which is higher. It is going to be a lower price and define market power in some circumstances where you might not find it if you are at your starting point.

DR. CARLTON: So, the point of the question is to show that there is a difficulty in defining market power when you cannot define the competitive price. You can define a rate of return, and you can define marginal cost in this example and prices above marginal cost in this example, but profit is zero, and there seems to be a complete ambiguity between the willingness of people to distinguish which of those two definitions they are using.

Is it price above marginal cost that is market power? Is it rate of return above a competitive level, or which of the two, or are those two different things? They obviously from an economic point of view are two different things, yet often, in the writings and in case law, they in my mind do not get distinguished.

MR. NELSON: I mean, yeah, you want to have profit -- you want to be able to make a monopoly profit. I mean, if you have got easy entry, as some of the different -- you know, if you don't have any profits, then they are not going to have enough -- but I --

DR. CARLTON: Larry, did you want to say something?

DR. WHITE: But why would we be interested in your hypothetical? If it is somebody coming in and saying, "That guy is charging an outrageously high price, Judge, find him guilty of a section 2 violation and mandate that he charge a lower price," we do not see that all that often, but that would be a problem. If it is, "Judge, that guy has excluded me from offering my rivalrous product, and had he not excluded me, I could have come in and the price could have been lower," that's a different --

DR. CARLTON: I agree, but that is mixing together two different questions. The first is, what is the effect of this action? If you can answer that question, you have answered the section 2 -- you have resolved the section 2 issue.

DR. WHITE: And then we do not have to worry about it.

DR. CARLTON: And then we do not have to worry

about market definition; however, the way the courts seem to use market definition in section 2 cases is not like that at all. Courts seem to do the following:

Unlike a merger context where you ask, as a result of a merger, is market power going to go up, the courts define a market and then look to define market share. Courts do it. They do not look at the change in the market shares that arise as a result of the bad act. They do not do that. That would be an analogy to a merger case.

Instead what they do is they ask, is there market power? They do not ask about the change in market power, but they ask, is there market power? They use that as a screen whether to then further investigate, and that distinction, that asymmetry between a merger case and a section 2 case, I think leads to peculiar discussions, but it also I think leads to exactly why I am asking this question, which is, if the courts are going to go this route and use market definition -- I agree with you, Larry, if you do an effects-based analysis, you can solve the problem -- but the first question the court is going to be asking, is there market power, and I am just trying to figure out, can we even define what we mean by that in this Cournot example?

MR. SIMONS: I think what you want to ask is why are we doing this, why are we engaged in an exercise, before you can even think about answering the question.

DR. CARLTON: This firm has been sued, there is a bad act, and the first question is, does he have market power? And I am trying to find out -- I cannot answer that -- begin to answer that question unless we can agree on a definition of market power. So, is the definition price above marginal cost or is the definition rate of return above the competitive level?

Mike?

DR. KATZ: The problem is if you are going to say this has to be a screen that works for everything, then the most useful definition of market power would be does the firm have at least one employee or something that is equivalent of it so we throw this screen out, because what Larry has pointed out -- I think what in most cases makes sense is something that says -- and actually, I make a different distinction, and I think, actually, a lot of economists writing not as part of antitrust make a different distinction. I think a lot of people, economists, would say that market power would be facing downward-sloping demand curve and not having it perfectly elastic, which then would end up giving you the profit-maximizing price of that firm above marginal

cost. I think that is a useful definition of market power.

Then I try to reserve monopoly power for being two parts. One, that you have a lot of market power, which is to say the price would be -- and again, I will be vague -- but significantly above marginal cost, and I would typically put in a test saying for I think most purposes or a lot of them, we do care whether or not the price is above average cost, whether or not there are profits, but what Larry has pointed out, I think correctly, is that test does not always work, that if what you are worried about is somebody who is in there now and is just breaking even but is narrowly keeping all sorts of more efficient entrants out who could make a profit, I think in that case, saying, "Well, look, they are not making money, there can't be a problem," would give you a misleading answer.

MR. NELSON: That was my standards example I gave in my opening talk.

DR. CARLTON: I think, again, that is really asking the but-for price; in other words, price may equal marginal cost and price may be above average cost in the present environment, but but for the bad act, that would not occur, okay?

The distinction you make between price above

marginal cost and then whether the rate of -- the price above average cost, the rate of return is above the anticipated return, is exactly the distinction that I made between market power and monopoly power. It is a logical distinction. I am not sure -- we may be the only two people who make that distinction, because I do not see the legal cases going in that direction.

So, I guess I do have a question, and I think it is a relevant question, as to whether the distinction between monopoly power and market power that we do see in the cases, is that a useful distinction, and is it a useful legal distinction? Is it a useful economic distinction?

So, maybe, Andy, you could answer that and maybe Rich.

DR. GAVIL: Yeah, one point I wanted to make earlier and I think I can make it now in answering the question, I think historically the association of market power and monopoly power as being different things was linked to market share. It was linked to circumstantial evidence as the basic mind set that we used to approach cases, and I think a concrete example of this is the Supreme Court decision in Copperweld, where it says -- it is known for the parent/subsidiary enterprise conspiracy issue, but it has a very interesting

discussion of the relationship between section 1 and section 2, and it says, "An unreasonable restraint of trade by a single firm is not reached under section 2, and therefore, the drafters of the Sherman Act left a gap between section 1 and section 2, and the implication was that for a section 2 case, you need something more." At that moment in time, the "something more" was the 70 percent or more market share as opposed to the 40 to 60 percent that was typical in rule of reason cases.

If you let go of the commitment to the Alcoa framework and the market share associations and start thinking about market power in different ways as expressing itself in different ways, that kind of mind set of distinguishing market and monopoly power based on market shares goes away, and I think that that would make a big difference in how we think about antitrust generally.

But you have said it several times, Dennis, and it is clearly the case, that courts say, "Okay, the first element under section 2, do you have monopoly power?" On your no profit example, if I could just throw in, what if the purpose of the conduct was to make that firm profitable and that is what it was trying to do? So, currently it is not profitable, but the whole point of the conduct, maybe it affects entry barriers,

was that they are trying to get profitable by engaging in conduct. Again, I think it shows the link between the conduct and the power increase.

DR. CARLTON: Rich?

DR. GILBERT: Yeah, if I can answer this, as has been said before, in some sense I subscribe to the argument that monopoly power is a lot of market power, but it is also market power that is durable. Now, whether you define durable market power in terms of the ability to raise price above average cost, the ability to maintain price above average cost, or the ability to maintain price above long-run marginal cost, I do not think that is really critical. To me, it is the ability to exclude, and as you have noted, Dennis, yourself, that when you are talking about exclusion, obviously it also depends on thinking about entry barriers, and then when you think about entry barriers, you have to think about what would happen in the market if entry were to occur.

So, if you had an extremely competitive market post-entry, maybe a little bit of exclusion is enough to maintain a monopoly position, but I think the key issue is the ability to exclude is important to me, because it says something about the ability to maintain price above some measure of long-run profitability of an efficient

competitor.

I want to add one other comment that I think is related to all of this, which is we are very good when we talk about impacts on competition to understand that impacts on competition is different from impacts on a competitor, I think we have learned that one, but when we talk about section 2 cases, we are often talking about the market share or monopoly power of a single firm. Shouldn't we be talking in many of these cases, at least, if not all of them, about the power in the market, not just the power of this firm, because obviously if the firm reduces supply so that its market share is below the Alcoa threshold, but in doing so, raises market power generally in the industry, that is a problem, and we want to look at that, not just what the firm's market share is or focusing on the firm.

Now, if you did this firm-specific residual demand analysis, then you pick that up by looking at the elasticity of the residual demand. So, I think it is all right in that context.

DR. CARLTON: Let me go back to something that sort of was a common theme in some of the presentations. Let me restate it as follows: It really has to do with what the benchmark price is.

If you look at a firm in a section 2 case and it

is engaged in a bad act, can you then ask, "Well, does that firm have market power," which is what the courts first ask, and if the answer is no, they throw it out. In order to answer that question, you have to ask, "Well, what would the price --" depending on your definition of market power, you want to ask, "Does the firm have market power?" Whatever your definition is, whether it is pricing above the competitive level after the bad act, are they pricing above the level but for the bad act, whatever definition you want to use, and I think it is the latter definition that makes more sense, it is not obvious why market shares and market definition help you answer that question, because if you know the current price and you knew the benchmark price, it is just a comparison of two prices. So, calculating market share in that case does not advance the ball.

If that is the typical case that we see in section 2, what really are we talking about when we are doing market definition? Are we really doing an analytic economic exercise, or are we doing something -- or are the courts doing something much more -- I don't want to say sensible, but much more using common sense, which is there are five guys doing the same thing, don't bother me, and they're just using their common sense.

Now, how you define "five guys doing the same

thing" may be hard, but it seems to me that is what a lot of courts are doing, and I am wondering if we are worrying too hard about defining markets in cases where market definition is just this seat-of-the-pants thing that the courts then use, and as long as they understand it is real seat-of-the-pants, don't bother me with details about market shares and get on to your competitive effects analysis.

So, maybe, Joe and Mike, you could comment on that.

MR. SIMONS: Yeah, I think that what the courts will do is not just say, well, let's get on with it and let's get to the competitive effects. It is a real screening event, a big one, and it also seriously impacts what happens when lawyers counsel their clients. If there is some chance that your client is going to be deemed to have a big market share, at least most lawyers I know will give advice that is much more conservative than if their shares are 30 percent. So, it makes a big difference in the real world.

I think the judges do focus on it, and it is important in court now, and there is a serious question in my mind about how important it should be, certainly with respect to how the Antitrust Division and the FTC exercise their prosecutorial discretion -- whether they

really need to get hung up on this or whether they really need to make a decision about what is the impact of whatever conduct we are worried about. Did it have a significant impact, and then, when we are proving in our case in court, it is a different exercise.

DR. CARLTON: Okay, who did I say? Mike?

DR. KATZ: You are not supposed to remind me of that. No, I would say a couple things. Part of it -- I will come back to what I said in my presentation, though, is that we can be using market definition in a number of different ways and that the level of -- we want to understand who the competitors are, because we want to figure out that is where we are going to see the competitive effects, are they harmed or not, does it matter if they are harmed, does it matter for competition and for consumer welfare. So, that level, I think we would certainly want to do market definition, but that may not be through a formal algorithm.

In terms of your question about the alternative prices, I think there is a difference between asking about a but-for price and asking about certain interpretations of the competitive benchmark, because you can take a competitive benchmark to be some formula based on marginal cost or average cost or something like that, and you could ask a market power question, but you

could well conclude from that that yes, this firm has market power, but it has not done anything wrong, okay?

It has market power because it has been a great innovator. So, I think that that is a different question than asking is it charging a higher price than the but-for price, because there you are asking about what would happen as a result of the specific piece of conduct. So, I think if one wants to go through the market definition exercise in that form and to have the competitive effects analysis be different than the market definition analysis, I think you can do it. One would ask about almost this more abstract or formulaic competitive price as the benchmark for market definition, and then the competitive effects analysis would look for a but-for price and would take into account a specific practice.

DR. CARLTON: I just don't know how to do the first in an analytic way that is other than comparing the two prices. If I cannot compare the two prices and I have to do a competitive effects, say an econometric analysis, I do not really need market definition. So, that is why I think what judges often do is, as Joe described, is do a seat-of-the-pants analysis or I described as a seat-of-the-pants analysis, but as Joe described, that is their screen.

DR. KATZ: Well, the screen makes sense if what the plaintiff is saying is there has been successful monopolization and you end up coming out of this being convinced that here is a sensible market definition that tells me how competition works, and this particular firm does not seem to be dominant in any sense or doing well, and if you see that, then it seems to me it does pretty heavily undermine the claim that there was successful monopolization.

DR. GILBERT: But that's Cellophane. I mean, it is Cellophane, did not look like they were --

DR. KATZ: No, Cellophane, they did not have the sensible market definition.

DR. GILBERT: Then you are back down to how do you define the market.

MR. SIMONS: Dennis, think about it this way: Someone had mentioned a gap earlier, and maybe it was Andy. If you think about under section 1, right, if you prove an effect, you win, right? Under section 2, the way you are describing the state of the law, which is accurate, is it is unilateral conduct. No contract. There may be an effect, and then liability is going to turn on whether there is some high market share.

DR. CARLTON: Right.

MR. SIMONS: So, the question to me would be,

why do you want to do that?

DR. CARLTON: I think that is right. Let me flip the question a bit.

It seems to me this emphasis on market definition in section 2 cases is coming precisely because of the way judges apply these screens and that -- I cannot remember -- I think Andy mentioned it, that just like you might want to have decision processes based on market shares, you might also want to immunize certain types of safe -- have safe harbors and as well as have danger zones, and it is the fact that it seems to me that the sequential decision-making in Section 2 cases is first to look at market definition as a screen and then you go to competitive effects that causes this undue emphasis on market definition, and one way around that might be -- and this is going to be a question I will ask Andy and Phil -- suppose we also allow a screen based on safe harbors and said, "No section 2 cases if you're doing X, Y and Z; no section 2 cases if market share is -- you do not have market power."

Wouldn't that be a way to de-emphasize the role of market definition, which I think we are all agreeing is difficult to define in a section 2 case?

Let me first ask Phil, and then he --

MR. NELSON: Okay, wait a second, no market --

DR. CARLTON: Either you do not have market -- the current screen, but I am going to add to that current screen that there are certain safe harbors, and what we should do is spend more time on defining the safe harbors for conduct rather than trying to figure out can we define markets any better.

MR. NELSON: So, it is conduct safe harbors, not --

DR. CARLTON: Correct, yes.

MR. NELSON: -- not structural safe harbors.

DR. CARLTON: Correct.

MR. NELSON: Okay, there was an "and" there, and I was starting to think that maybe where you wanted to go was a combination of a structural safe harbor with a conduct safe harbor, because there are certain types of conduct that might mean a lower market share, you could still have a problem, like some of these -- but I think there is a -- as I was alluding to, the importance of performance evidence, which is another way maybe of saying conduct, that you would want to start looking at some of that conduct evidence.

However, I am a little worried that the problem is that a lot of this conduct is not so easy to categorize, so that when you start to try to define a safe harbor using conduct evidence, I am not sure that

you are going to find a lot of situations where you can say for sure that this is conduct that is absolutely okay, because in other contexts, it may not be.

DR. CARLTON: I agree. Safe harbors make mistakes, but that is what decision theory tells us is the right thing to do.

Andy?

DR. GAVIL: I think the idea of defining safe harbors and danger zones, as I said, is useful, and I think you cannot do it just by using market share numbers, which has been our tendency in the past.

Now, once you use a market share number, you are stuck in the, "Okay, we need to define a relevant market problem." So, I think that reducing it to certain characteristics of the market, maybe it is structural characteristics, performance characteristics, but trying to look at other kinds of measures might make the safe harbor and the danger zones a little bit more meaningful and move the attention away from market share.

But one last comment, Joe said how this affects you in advising clients. That 70 percent share that has become pretty fixed for monopolization cases, that is perceived, even by defendants who do not like the market definition and market share approach analysis, that is perceived as a pretty big, significant safe harbor when

you are advising single-firm clients, and keep that in mind with all the monopolization cases.

If there really is not any good, strong argument that you could be in a market with a market share that is up in that range, you are pretty much free to do whatever you want. So, if we moved away from it, I suspect you would actually hear some objections from large firms that perceive that it is actually a very useful benchmark.

So, where I would come out is, I do not know that you can completely get away from the market shares, but maybe we need something like a market share plus, and not that it is a great model that we would ever want to rely on, but the concept from the Sentencing Guidelines that you have a guideline, but then you have factors that allow you to depart upward or downward, and that is sort of what Michael was talking about earlier when he was answering one of your questions, is certain factors might lead you to be cautious or less cautious in certain circumstances.

DR. CARLTON: Let's see, let me skip a few questions since I am going to try and end roughly on time or maybe at most five minutes late, but let me ask a question about technology, and I am going to direct this to Rich and Mike, because you have done a lot of

work in these areas.

It seems like a really hard question is where you have industries where marginal cost is low, product innovation is the key, and new products are coming out every so many years. It kind of came up a bit in the Microsoft case, and Dick will probably talk about this tomorrow, Schmalensee, but what do you mean by "market power" in those industries unless "durable" really means more than a year or two? Is that the right thing to be focusing on? If it is, if it is focused on in those industries, is it -- let me rephrase it. Is our focus on price misleading us and should we be focusing on other things?

DR. GILBERT: Well, I do not view that -- you have asked a lot of hard questions. I do not think this is one of the hardest questions. I find it relatively straightforward in the sense that when you are talking about dynamic competition, Schumpeterian spiral competition, it is very much like thinking about entry analysis. There is some probability that entry will occur at some date. The question is how soon will it be, what will be the magnitude of it.

There is also I think a legitimate question that even if entry is going to occur, is that going to neutralize the type of conduct we are concerned about,

or does the conduct we are concerned about promote entry or retard entry? It is my view that these are questions that can be addressed within the context of the way we do antitrust analysis generally.

Now, it is, of course, the case that in high technology industries, you are more likely to get very high price-cost margins, so you are more likely to be worried about market power, but it is often benevolent market power, and if it is benevolent, you should not be doing an antitrust case. So, it is more like magnifying the things that we are concerned about but not changing the qualitative way that in my view you should take them into account when you are doing an antitrust analysis.

DR. KATZ: I have a couple of things and maybe tie it to Microsoft. I mean, one of the things to remember is when the Government was looking at Microsoft, when the Government was dealing with them in the mid-nineties, everybody pointed out, "Well, look, it's such a fast changing market, and yes, it is true that Microsoft dominates personal computer software today and Apple is a distant second, and there are these other things that aficionados use, but they really have not caught on, and now here we are 12 years later and, okay, all of that's the same." So, this whole thing about the fast-paced -- and certainly Linux is doing

better than, you know, "the operating system" did, but sometimes we do tend to exaggerate the rate at which we think markets change and certainly relative to the pace of antitrust enforcement.

But the other thing is, I think, Microsoft I think is an interesting case, and maybe it comes back to one of Larry White's points, that the Microsoft case, I think it is fair to say that both sides took a Schumpeterian view. Microsoft said, "Look, this is Schumpeterian competition, someone else could come along, they will displace us, because of network effects, you would expect the winner to get a very high share in operating systems, and so leave us alone, because that's how competition occurs," and the Government said, "Okay, look, this is Schumpeterian competition. If you guys didn't do bad things --" Greg is shaking his head. Now, it is true, sometimes the Government didn't say that, but I think the only sensible interpretation of what the Government was saying was, "This is a Schumpeterian market, and, Microsoft, you are trying to stop the next wave of innovation that would have displaced you," and I am saying that's somewhat like Larry's point about saying it is not just how well you are doing in some absolute sense, but whether there is a threat that you are trying

to stop that would leave you worse off.

So, I mean, I think in that one is the Schumpeterian view was consistent with saying we have to intervene, although it does shift what you look at.

DR. CARLTON: All right. Well, we are about out of time, so I want to end with this, to get everybody to comment on this question.

In light of all the difficulties and ambiguities with the use of market definition in section 2 cases, is it your view that we should still rely on it as we do, put less reliance on it, or go to a competitive effects and forget about market definition? So, why don't we just go down the table in order.

MR. NELSON: Okay, I think I am halfway between your two extremes, because I think there are -- as I say in my slides, I think that there are organizing principles and things that the exercise -- the market definition exercise helps you understand what is going on and tell either a story or an analysis that is internally consistent, but that is not to say you have to do it in every case, and there are numerous cases where you may be able to expedite things by going straight to the competitive effects bottom line.

MR. SIMONS: My take would be that the DOJ and the FTC should try to come up with something that

focuses only on competitive effects, does not worry about market share, and then see what happens over time in terms of what they come up with and how operable it is. And if the thing really works, terrific, then try to get it into the courts, but not worry about that at the outset.

DR. WHITE: Yes, we ought to be looking -- I have a feeling we are going to be having all of the divergence of opinion ranging from A to B. Yes, you ought to look at competitive effects more than we have, but I think there is still going to be a role for market definition. Think about the private suits, not the government suits, but the private suits that were brought against MasterCard and Visa, and these were -- you know, the -- say take a WalMart case. This was a tying case, but they were not -- it was -- you could tell some stories about how if the tie was not there, there were -- there would have been more entry somewhere in -- in the credit card markets, but it was primarily the tie is preventing us merchants from doing something we would like to do.

I am not sure a competitive effects analysis is going to tell you about market definition in that particular case. Of course, MasterCard and Visa were telling you, oh, all kinds of transaction media are in

the market, you know, cash and checks and everything, we do not have market power, and they were actually trying to say it with a straight face.

A market definition paradigm I think would help in that kind of case, and so yes, I think we still have need. I am hoping this is 1981, and next year, some smart people are going to come in with a useful paradigm.

DR. CARLTON: Andy?

DR. GAVIL: I think I agree with Larry. I think it still has a role to play, but I think as you stated, I think I would agree also that we over-rely on it, and I think somewhat complex is the problem of over-reliance. I think it can lead to both false positives and false negatives, but I think with the false positives, if somebody is found to have monopoly power, to some degree, you have the backstop of the conduct inquiry.

My concern is because of the high process costs in trying to prove monopoly power in this -- as you described it accurately -- sequential model, you get false negatives, and there is no backstop to that. The case ends, and the court does not look at conduct, does not look at effects. So, I think this is an example where the over-reliance may actually increase the threat

of false negatives more so than false positives.

DR. GILBERT: I would join the chorus that we need more emphasis on competitive effects. A good example, not necessarily really in the section 2 context, is the Oracle merger case where in my view there was some certainly interesting evidence, if not dispositive evidence, about competitive effects, but once Judge Walker determined that he could not define a market, he then concluded that there was no market, and the competitive effects were almost ignored in that case, and to me, it is like saying that I do not know exactly where downtown Los Angeles is, and therefore, there is not one. But I also can sympathize that if we did away with market definition completely, it could be highly problematic in leading to a lot of cases.

DR. KATZ: Okay, well, I guess I will say, at the risk of sounding like Bill Clinton, it depends on what one means by doing market definition, and I think a lot of times what people mean is they mean applying the hypothetical monopolist test, they mean doing a concentration analysis, and they mean trying to come up with boundaries with certainty, and then slavishly applying that, and if you cannot meet that, you throw the case out.

I think that way of doing things is surely

wrong, but I think we also surely do want to do some sort of market definition exercise in the sense of identifying the competitors, and I think where we have come up short is what is the right way to do it in the middle in terms of I think we still do not have a very good sense of what is the right algorithm and the right approach in different situations.

We have not mapped out, so, here is exactly where you could do the hypothetical monopolist test, here is where we need to do some alternative methodology. We do not have that, and I think the courts -- sometimes, the fact that we do not have that has become an obstacle to good decision-making, as Rich was just saying in the Oracle case, but I think the bottom line is we need to figure out a better way to do market definition, and that way we will recognize that it should not be taken overly seriously or applied too mechanically.

DR. CARLTON: Thank you very much. I want to thank the people at the Department of Justice and the FTC who did all of the legwork in putting this together, and I am sure, although I have not checked with them, all of the panelists, myself included, thank Larry White for not including us in his slide of dumb quotes, and I want to personally thank everybody on the panel for

coming and giving us the benefit of their substantial expertise. I have learned a lot, and I thank you all.

(Applause.)

(Whereupon, at 12:36 p.m., a lunch recess was taken.)

AFTERNOON SESSION

(2:01 p.m.)

MR. WALES: Well, good afternoon, everybody. Thanks so much for braving the cold and the snow. I think we have a very exciting panel on tap for this afternoon. For those of you who were here for this morning, I hear it was very lively, and I am hoping that we can live up to that and be lively as well.

My name is Dave Wales. I am a Deputy Director here in the Bureau of Competition at the Federal Trade Commission. I will be moderating today, along with Greg Werden, the panel. Greg is the Policy Project Director At the Economic Analysis Group at the Antitrust Division of the Department of Justice. That is his official title, and you will be hearing more from him shortly.

Have you been elevated perhaps?

DR. WERDEN: I have never even heard of that title.

MR. WALES: Is it better than the one you have?

DR. WERDEN: No, not really.

MR. WALES: Not really? Sorry about that, Greg.

Before we get into substance, it is my job to do a little bit of the housekeeping. First off, what I would like to do is on behalf of the FTC, to really thank our friends at DOJ in putting this together, and I

think it has been phenomenal to date, and I am sure it will continue to be that way. I would also like to thank each of our five panelists today for, again, braving the weather and coming out, and I think we have got some great issues to discuss.

Today and tomorrow, I guess today and tomorrow, we have the hearings on monopoly power, and I guess what I wanted to point out is that next month we will be turning to the issue of remedies, which should also be pretty interesting. Stay tuned for that. I guess what we typically do is post the schedule on each agency's web page, so look out for those.

A couple housekeeping items. First, I guess we ask that people turn off their cell phones, BlackBerries, any other electronic devices that make annoying noises. Second, importantly, restrooms are out across the lobby. In case someone needs to use those, follow the signs, you cannot miss them.

Third, a safety tip for everybody, I guess in the event the fire alarms do go off, please do not panic. Please walk towards the exit, and we will guide you to I guess a safe place across the street where we will gather, hopefully with warmer coats.

Lastly, I guess the way we set this up is we ask that the audience please not ask questions, and we are

going to have a lively discussion today, so you can look forward to that.

Many of the prior sessions talked about obviously the conduct involved in section 2 challenges, and today, what we would like to talk about is a separate topic, which is, of course, monopoly power and defining markets when monopoly power has been alleged, and I think that is a pretty important topic, one that I think when the hearings kicked off, that Herb Hovenkamp and Dennis Carlton identified as being one of the two that they thought were probably the toughest and two that needed a lot of discussion. So, hopefully we will be able to accomplish that today.

I think that is pretty much what I wanted to say, Greg. I don't know, maybe you want to give your title and anything else you want to say.

DR. WERDEN: Yes. Hi, I am Greg Werden, Senior Economic Counsel in the Antitrust Division, Department of Justice. I just want to add my thanks to our panelists and the staffs of the two agencies for organizing this session.

MR. WALES: Great, thanks.

The way the format is going to work today is similar to what we have done previously and did this morning. First, we are going to have each presenter

give about a 15 to 20-minute oral presentation, and then what we will probably do is take a break either in the middle of that or towards the end of that, we will see how long things go, after which we are going to have a moderated discussion where we will give each panelist an opportunity to respond to the other panelists and also for Greg and I to pose some questions and some principles that we think we might be able to move towards convergence on.

With that, I guess what I would like to do is introduce Simon, our first speaker. Simon is a partner and co-founder of RBB Economics. He has been advising clients on competition policy issues since 1991 and has particular expertise in applying empirical techniques in the context of merger investigations. In addition to his private sector work, Simon has been seconded for a short period of time to the German Federal Cartel Office, where he gave a series of seminars on use of economics in competition law. Simon has published widely on virtually all aspects of competition law economics and is a regular speaker at competition law conferences. He is a co-author of The Economics of EC Competition Law and has worked on several hundred competition law matters spanning virtually all sectors of the economy. Thanks, Simon.

MR. BISHOP: Long intro, and you forgot to say I am from Europe. I am up first, and given that it was probably a lively session this morning, I think probably the reason I have been chosen to go first is because my topic this afternoon is probably the dryest and most technical, which is my remarks are really going to concern the Cellophane fallacy and what implications that has for a structural approach to assessing monopolization or what we Europeans talk about as an abuse of dominant position.

I am also going to say that my remarks are also sort of Euro-centric in the sense of this really reflects my experience of EU cases and European national competition law cases and not really the U.S. case law; however, given that we are all in this facade, one might say, or claims that there is increasing convergence between Europe and the U.S., I hope that some of these remarks will actually carry over to U.S. antitrust.

Now, in order to give this some sort of context, in Europe, as in the U.S., we are engaged in an ongoing reform of Article 82, which is the equivalent of the monopolization act, and last year, the European Commission, of which Miguel was heavily involved, issued guidelines on how to reform Article 82 and to move the current system away from a form-based approach to a much

more effects-based approach.

Now, that is all very admirable, but it seems to me that within these guidelines of reform, there is the elephant in the room which no one really wants to talk about; namely, the concept of dominance. Really, dominance is also based on structural market share. In Europe, we have the two-step process, whether a firm is found to be dominant and then whether, if that firm is found to be dominant, whether that behavior constitutes an abuse of a dominant position.

Now, as I said, all the focus has been on the second step, but the problem is is that within Europe, certainly how the courts have interpreted dominance and, indeed, some of Miguel's colleagues in the Commission also, is that if you are dominant, then any behavior which affects or harms competitors is almost deemed to necessarily harm competition, and if you take that approach, then that really means there is no role for an effects-based analysis within European antitrust under Article 82.

It also means that the dominance, and therefore the market share calculations and market definition, are absolutely paramount in the whole assessment. Now, we all know that from the sort of 1982 U.S. Merger Guidelines, there has been pretty wide acceptance that

the hypothetical monopolist test or the SSNIP test has provided the appropriate framework for assessing and defining relevant markets. We also know that, even though we have the framework and that is well accepted, in actual individual cases, it is actually quite hard sometimes to actually implement that test. Actually, in monopolization cases or abuse of dominance cases, things are even more difficult because of the existence of the Cellophane fallacy.

Now, what is the Cellophane fallacy? What are the problems? Well, in a merger context, which is where the SSNIP test or hypothetical monopolist test was first proposed, we are interested in what has the merger changed? Is it going to relax competitive constraints at prevailing price levels? Now, that has an important implication, because that says we can use existing data, observed data, to assess the strength of existing competitive constraints between products supplied by the merging parties.

However, when we talk about monopolization cases, in many cases -- and some might argue in all -- the relevant issue is not whether the prices can go up even further from prevailing levels, but actually, have prices already been increased above competitive levels? Now, the important implication of that is that using

observed data will tend to overstate the competitive constraint, because as we know from the famous DuPont Cellophane case, is that even a monopolist, if you put up prices far enough, something is going to start looking like an effective substitute at some point, because even monopolists face some constraint. So, the real issue here I think from the Cellophane fallacy is what implications does it have for the use of empirical analysis?

Now, that is a case of sort of, well, what do we do about this? We know that the Cellophane fallacy exists, and we know that that has a big impact on how we can interpret and use existing data. Well, there are a number of approaches which have been put forward to try and address the Cellophane fallacy. One which has been put forward in a number of cases both by the European Commission and some national competition authorities in Europe is to say, "Well, the hypothetical monopolist test is only one way of defining a relevant market."

Well, the question or the problem with that sort of line of argument is, they do not actually tell you what the alternative ways of defining a relevant market are, and what is good about the hypothetical monopolist test is it is forcing people to at least think about the scope for demand-side substitution and supply-side

substitution, and if those two things are not part of the approach of defining a relevant market, it seems to me that, indeed, any other alternative approach is useless for antitrust purposes.

The second approach to trying to deal with the Cellophane fallacy is, "Well, let's just recalculate everything from the competitive price." Well, great idea, but if we knew what the competitive price is, then we would not need to be defining what the relevant market is. We could just say, "Well, we observed that Firm X is charging 10, we know the competitive price is 5; therefore, there must be some sort of exercise of market power going on." But that is not how the real world works.

So, as a slight anecdote here, I was reading in some of the trial transcripts in the Microsoft case, one of the economists I think it was for the DOJ was asked, "Well, what is the competitive price that Microsoft should charge?" The answer was, "Lower than they currently charge," which seems to me sort of just demonstrate the difficulties of actually re-adjusting what the competitive price is. So, that is not going to get us anywhere.

The third approach is, "Well, let's just ignore the Cellophane fallacy; pretend it does not happen."

Well, again, that is not going to work, because if you ignore it and just apply empirical analysis, you are going to tend to define relevant markets too widely, and therefore, not capture some market power when we should be capturing it.

The fourth approach which has been proposed, which is, "Well, let's do away with market definition altogether. It is difficult -- we have got the Cellophane fallacy, you know, we are very smart economic professors or consultants, and we can just sort out -- you know, market definition is just an interim step. We can go straight to the answer." Well, personally, I am a bit more humble than that, and I think if we see the relevant market definition and the structural analysis for what it is, i.e., an intermediate step, I think it is important that we keep that step.

Secondly, if you do away with it, it actually introduces real scope for ad hoc analysis. There is a real -- we know that particularly in the areas of exclusionary abuses or exclusionary power, trying to discriminate between behavior which just merely harms competitors and is therefore procompetitive from that which harms competitors and drives them out of the market and leads to harm to consumers is very, very difficult, and really, the market definition structural

screen provides a good touchstone to prevent people from adopting "I know abusive behavior when I see it."

So, I think that sort of a summary of this is really we are stuck with the hypothetical monopolist test, the SSNIP test, as a framework for thinking about how we define relevant markets, and we are also stuck with the Cellophane fallacy. We need to accept that it exists. So, what are my proposed implications for the sort of policy?

Well, a structural analysis still can provide a very useful filter, and even recognizing the existence of the Cellophane fallacy, I think we can go through a number of steps, that we can define relevant markets which are consistent with the basic principles of the hypothetical monopolist test. So, if someone proposes a relevant market and that it does not seem to be consistent with the principles of demand-side substitution or supply-side substitution, then it is not a relevant market. So, I think even just using the SSNIP test as a thought process can actually provide a useful discipline on how to define relevant markets.

Secondly, we know the Cellophane fallacy exists, but if the parties are arguing for a wide market definition, then they at least ought to be able to demonstrate that at prevailing prices, there is

substitution. Now, that means that it does not stop with saying, "Well, the price has already been increased above competitive levels and is subject to the Cellophane fallacy," but at least they should be able to show that at prevailing prices, there is a competitive constraint between product A and product B if they are arguing they are in the same relevant market.

The third element I think is we can look at product characteristics in the marketplace, but again, I think we should be careful about how we look at that, and this really goes back to my first point, which is consistency with basic principles, is it is not saying that these two products are not in the same relevant market because they look different or have different product characteristics. We are saying they are not in the same relevant market because the differences in product characteristics imply that demand-side substitution or supply-side substitution is unlikely.

The fourth element is that there are some cases and there is some evidence which is not subject to the Cellophane fallacy which we can use to discriminate between competing claims, and as always, there is a paper by Greg Werden, who addresses this, and I think it was from about 2000.

The second policy issue is, well, we have

defined the relevant market, we have calculated some market shares, and clearly we need to put that into context. We need to take into account the scope of all barriers for entry, expansion, the scope of buyer power, whether the market is subject to bidding competition, and also general market dynamics.

My final comment was really, well, let's be humble here, because we can go through all of these steps, but in a lot of cases, the available evidence will not allow us to discriminate between the wide market definition which the parties are putting forward and the narrow market definition which the agencies are going to be putting forward. Everything may be consistent with the basic principles of the hypothetical monopolist test, the parties can show that at prevailing prices there is substitution and so on and so on, and where you have got these two competing potential market definitions, sometimes that will not be a problem, because the market shares in both of those may be low, and then unlikely to have market power. Alternatively, market shares in both of those could be high, and then that is not really a problem, because the market power is reasonably high. The difficulty or the problem, potential problem, is where in one market, the narrow market, the firm has a high market share, and in the

wide market, it has a low.

It seems to me when you are in those situations, all it says is, well, then we really need to have some pretty good evidence and examination of the business conduct, and this I think brings me back to where we are in Europe, is that a lot of times in Europe, with the current situation, the business conduct is not assessed on the market effects, but actually on the form of the business conduct. So, the reform in Europe is certainly going in the right direction in focusing on the form, and that is the end of my comments.

Thank you.

MR. WALES: Thanks very much, Simon.

(Applause.)

MR. WALES: Our second speaker is Miguel de la Mano. Miguel joined the European Commission in 2001 and is currently a member of the Chief Competition Economist's Team. He carries out economic analysis in mergers and commercial practices by dominant companies and their impact on the competitive structure of the markets. He is also responsible for drafting guidelines, setting the Commission's analytical framework in these areas, a key area. He completed graduate studies in economics at The Institute For the World Economics in Kiel, Germany and The European

Institute at Saarbrucken University, Germany. He conducted his Ph.D. research at Oxford.

With that, Miguel? Thanks.

MR. de la MANO: Thank you very much. It is definitely a pleasure and also a great honor to participate on this panel today together with so many distinguished and well-experienced practitioners.

I will try to contribute to this issue basically by offering a view or an assessment of the way in which dominance or the role that dominance plays today in competition policy assessment in Europe and which, as you know, is enshrined in Article 82, which is the equivalent of section 2 here in the U.S.

As you also know and as Simon has remarked, the Commission is in the process of reviewing its policy in the area of Article 82, and like every type of reform, it is somewhat case-dependent, and we are constrained by case law and case practice; however, we believe that the time is right basically to align the implementation or the enforcement of Article 82 to current thinking and current economic knowledge, and, of course, to a more modern analytical framework.

So, I will basically start by making a somewhat obvious remark, yet actually crucial, which is that in the context of the analysis of monopolization in Europe,

dominance is a necessary condition. That is how the system has been set up, and the EU Treaty actually prohibits single-firm conduct that harms consumers only when undertaken by a dominant company, and normally, to ensure the efficiency of the decision-making process, this also means that the first step of the analysis is to establish whether or not a single firm actually is in a dominant position or not. It is not a must, but that is just the best way forward. If a single firm is not dominant, then there is no need to proceed any further.

At the same time, a somewhat more subtle point, this also rules out what in the U.S. is attempted monopolization. If you are not dominant in the first place in the EU, basically there is nothing you can do that will violate Article 82, and I think this is an important point, because it somewhat dispels the myth that in the EU, there is a serious concern or serious worry with type II errors; namely, false acquittals. I think personally that is not the case.

But what are the reasons for this institutional setup? I can think basically of two primary reasons. Number one is to provide legal certainty. Surely it is better for firms to know in what circumstances they may be liable to and they are obligated to. There is also another reason, which is that we should not forget, it

was member states that have delegated the powers to a rather independent body, namely the European Commission, to enforce competition policy in their name, and when delegating such powers, member states want some assurances that these powers will not be abused, and therefore, forcing the Commission to start off by assessing whether or not a firm is dominant imposes some sort of discipline, which understandably was necessary for member states to delegate such powers.

However, unfortunately, despite the best wishes of everybody at the time, maybe 30 years ago, it has not fully worked, and I think there are three reasons why it has not fully worked, which I would like to share with you and hopefully also in doing so contribute to the thinking that is taking place here in the U.S. with respect to monopolization.

The first reason why they do not work is the concept of dominance is somewhat elusive. The member states put it into Article 82; however, no definition was actually provided. That was left for the courts to develop one over time.

However, as is normal, the courts were actually reacting to cases that were brought to them, and they were not necessarily thinking in the abstract, well, what is it that dominance should mean? How should it be

defined? But instead, we are reacting to the circumstances.

Of course, it became increasingly complex and increasingly difficult to understand exactly what dominance is as time went by and European courts were issuing rulings where the concept of dominance was mentioned or in some cases defined.

Of course, what happened ultimately is that, before the Commission, it became increasing difficult to identify what is dominance, and therefore, the more difficult it was, the more elements which would normally go into the competitive assessment creeped into the assessment of dominance, up to a point where it seems, at least to me, that as Simon pointed out before, assessing dominance became an end in itself to the extent that once dominance had been established, it was not just a necessary condition but almost sufficient for a finding of abuse.

Now, I think that these three concerns can be corrected, and this is, of course, the rationale for the review process, and I would just like to share with you the three ways in which I think this can be done.

So, first of all, again, a rather obvious statement, but somewhat important in a context where European courts have said that the dominant firms have a

special responsibility, whatever that might mean, dominance should be defined or equated with substantial market power. Now, of course, all firms have some market power, but most of them have very little, and accordingly, the relevant question in antitrust cases should not be whether market power is present or not -- it always is -- but whether it is important, that is, whether it is substantial.

In going back to the sort of most established definition of dominance by the ECJ, dominance is said to be a situation where a company has the power to behave to an appreciable extent independently of its competitors, customers and ultimately its consumers, and a close look at this definition suggests, indeed, that dominance can be equated to significant market power, and this is because a firm is dominant if its decisions are fairly insensitive to reactions of competitors and customers. That is what the "to an appreciable extent" actually means. Of course, no firm is fully independent of customers and competitors, that we know from economic theory, but to an appreciable extent, it might well be.

The measure of this sensitivity, of the sensitivity to the actions of others, is given by an elasticity, which is, again, the other side of the way that economists would measure market power in practice.

So, we end up with a situation where to behave independently to an appreciable extent can be definitely equated to an ability to significantly and profitably durably increase prices, and therefore, there should be no more debate about what is dominance, just substantial market power.

Now, how is this substantial market power to be established? Well, again, this is not new to anyone, but I would argue that first market shares have to be significant, and significant in two senses. First, they have to be significant in that they must be important, high, but also significant in that they are actually providing a good proxy for the relative insensitivity of the single firm to the actions and reactions of its competitors and customers. There is, again, a good paper by Greg Werden which talks about assigning market share and how difficult this process actually is.

The second point is that barriers to entry and expansion have to be significant, and by this I would like to emphasize that we mean in the absence of the conduct, not barriers to entry in general, but in the absence of the conduct, if the conduct itself actually increases barriers to entry or barriers to expansion. Now, that is part of the anticompetitive effects of such conduct, and therefore, it should not be seen as an

element that plays a role in establishing dominance.

Of course, there are other elements like dynamics of the market, there should be no technological leapfrogging, and buyer power, it cannot be shown that the customers have very little countervailing buyer power.

Now, I will try to make here a rather provocative statement, but in my view, the acid test, the way to ensure whether a company is dominant or not, is to ask, well, is it the most efficient in the market? Because if it is, it is likely to have high market shares, it is likely to be very difficult to enter successfully and profitably, and it is also going to be very difficult possibly to leapfrog.

However, one might argue, well, isn't this just the old efficiency offense? Well, I do not think this is an offense, because I personally think there is nothing wrong with being dominant. There is no offense in being dominant, and companies should not feel that an assessment of dominance actually implies that this is going to lead to a finding of anticompetitive behavior on their part. Quite the opposite, a finding of dominance should in most cases just mean that they are probably the most efficient company out there.

This takes me to the final point, which is that

dominance is not only a screen. It is not an end in itself. It is just a screen to try and filter out, as Simon was saying, those situations where there might be scope for significant harm to consumers resulting from certain conduct from other situations where this is very unlikely to happen.

Now, it is clear that if a practice is shown to be anticompetitive, the firm must be dominant, but proving that a practice is anticompetitive is hard, and it takes a lot of time and resources. Therefore, it seems like assessing dominance can play a very important role in acting as a screen, and it is also a screen that bites. It bites because large firms may not necessarily be dominant if innovation is taking place at a rapid place, if there is fierce competition between large players, for instance, in the concept of bidding markets, or if there is strong disciplining by potential entrants or customers.

Now, I am just going to briefly go into a non-hypothetical example, which unfortunately I am not allowed to get into further details of the market, but where actually I will be able to show to you that the Commission takes very seriously the dominance screen and it actually works in practice.

We had a case not long ago where the defendant

had very high market shares in a homogenous good market, above 60 percent. There were very important and significant barriers to entry, like large overcapacity on the part of the dominant company, declining demand, high fixed costs to establish new facilities, but also strong learning effects in the process. It was common practice in the industry to use very long-term contracts, which, of course, we argued would limit customer switching, and not the least of which the defendant seemed to be in a very strong position to fend entry given that it had the broadest product range and the largest financial resources. So, with this criteria on the table, one would very easily conclude that this company is actually dominant.

Well, actually, the Commission concluded it was not, and this was on five counts. First, there was significant buyer concentration. The top three customers took 70 percent of the market. There was product homogeneity, which allowed them to switch suppliers without incurring significant switching costs, and buyers, indeed, have dual sourcing strategy to shift volumes between suppliers with little transaction costs. Rival suppliers had significant overcapacity which they could use to expand, and therefore, there were no barriers to expansion. It was also found that the

competition mechanism was bidding for large and very occasional contracts, just every few years.

So, I would just like to conclude with two remarks, one on market shares and one on market definition, linking it to what Simon has said. First, on market shares, it is, often said that there should be a bright line safe harbor, and also that, only firms who are market leaders can ever be dominant. I think the latter makes no economic sense, and this is clear given the application of unilateral effects in the area of merger control, and, of course, at least in the context of European competition policy, the dominance concept plays a role both in mergers and antitrust, so they are interlinked.

However, bright line safe harbors do make sense; however, I believe the threshold should be set rather low, and this is for four reasons. First of all, rivals might be constrained. For example, in the electricity industry, this happens very often. You might have strong multi-market presence, like in the airline industry, if you have one company who is number two in a number of routes and the number one company in each one of the routes is a different one, one can argue that this company who was number two everywhere is actually more dominant or has more significant market power given

this multi-market context than anyone who just has a leadership position in one individual route.

Market leaders are more constrained by regulation than nonleaders, and that can be the case in certain industries, such as telecoms, and the leader may be more constrained by close substitutes or by new entry, for example, in the case of pharma. There was a case of AstraZeneca in the EU not long ago where this was clearly an issue.

So, what are the policy implications for not arguing that only if you are the market leader, you can be dominant? There are at least two. One is that for consistency, I will just mention unilateral effects in mergers, but also, to leave the door slightly open for attempted monopolization in the EU, in the EU policy.

Then just one very short and final remark on market delineation, which I will just start by saying that I agree with everything that Simon has said, but unfortunately, even though I think we ought to be humble and I definitely agree with that, the EU Commission is forced to be arrogant, because in a sense, we are obliged to take decisions. We have to say what we think about the market. We cannot leave definitions open. We have to say whether we think it is narrow or we think it is wide, whether or not we win the case, and this is a

problem.

This is a problem because we cannot just say, well, you know, let's ignore the Cellophane fallacy or let's think about the Cellophane fallacy as something that plays a very significant role and there is nothing we can do about it, so we just be humble. That we cannot afford to do.

However, I think we do not have to lose all hope, because when thinking about the role or the assessment that dominance plays, particularly thinking of dominance as a screen, I think that even if we recognize that the hypothetical monopoly test, the SSNIP test, is, indeed, a useful conceptual framework to identify competitors that are constraining a single firm, the assessment of dominance actually goes a step further, and not just ask the question, well, which are the firms that are there constraining the incumbent, but actually asking, well, how much are they constraining the incumbent?

So, in trying to figure out how much is the incumbent being constrained or the defendant being constrained, we can also have a good glimpse into which other firms that are part of that particular market, and therefore, market delineation can in some cases -- not always, but in some cases -- be a by-product of the

dominance assessment, and this obviously simply reflects that market definition is a means to an end, and what the real issue is is market power.

Thank you very much for your attention.

(Applause.)

MR. WALES: Thank you, Miguel.

Next up we have Tom Krattenmaker. Dean Krattenmaker is currently Of Counsel in the Washington, D.C. office of Wilson Sonsini Goodrich & Rosati, where he focuses on antitrust, telecommunications and trade regulation issues. Immediately prior to joining Wilson Sonsini, Tom was an attorney in the Federal Trade Commission's Bureau of Competition, Office of Policy and Coordination, where I had the pleasure of working with him for too short a time, but really enjoyed my time working with him. In that role he principally served as legal adviser to the bureau directors and to attorneys investigating and litigating antitrust cases and advised on several Bureau and Commission public reports. Previously he served as senior counsel in the Department of Justice's Antitrust Division and held positions at the Federal Communications Commission, including Chief of Telecommunications Merger Review and Director of Research and Co-Director of the Network Inquiry Special Staff. Tom has spent more than 30 years in legal

education. He was a Professor at the University of Connecticut, Professor and Associate Dean at Georgetown University and the Dean of William & Mary School of Law.

Thanks, Tom.

MR. KRATTENMAKER: Hello. I'd like to begin by thanking Dave and Greg for giving me this monopoly platform for 15 or 20 minutes and am particularly appreciative for you surrounding the platform with the entry barriers with your declaration that there be no questions from the audience.

I also would love to be able to take refuge in the defense offered by Miguel that he was forced to be arrogant. The problem is that there is at least one member of the audience I see here who was one of my law school classmates, so he knows darn well that I have chosen to be arrogant. So, what I would like to say honestly is that I am going to sound more assured about my views than I am. I have asked that on my tombstone they write something like, "Often wrong but never in doubt," so if you really do not like what I am saying, say, "Oh, Tom's just trying to be provocative again." Dave can tell you that he has said that many times and enabled himself to get home without going home in a funk or thinking that they have to let me go the next day.

The other thing I want to say at the beginning

is that aside from the fact that I am quite honestly flattered to have been invited to join this group, I am more interested in trying to respond to questions than saying anything in particular, so please do send up a flag after 10 or 15 minutes, and I will just stop. I have four points to make, and if we only get three of them out, I am sure I will be able to smuggle the fourth one in somewhere later on.

I am speaking largely off a text -- I am not going to read it to you -- of an article that I published with a couple of really outstanding antitrust lawyers and scholars, Bob Lande and Steve Salop in the Georgetown Law Journal in 1987 called Monopoly Power and Market Power in Antitrust Law. It turns out that even though that is 20 years ago, I think it is still right, so if you want to have a look at that, that is where I am coming from.

The first point I wanted to make I think is one where we could say I am preaching to the choir, so I will go through it quickly, but it is not a trivial point, and that is, what do we mean by market power? I think my sense is that in this room, we are all co-religionists; that is, we all think that market power is the ability to price profitably for a significant period of time above the competitive level for that

market.

I might just stop to observe that that has hardly been the history, the unbroken history, of antitrust. We have had many other tests of whether something is anticompetitive or not. Justice Douglas once opined that a merger was anticompetitive because it would lead to moving the corporate headquarters of the firm from a small town on the West Coast to big, bad New York City. Justice Black once told us that a merger was anticompetitive because there would be fewer single-store grocery stores in Los Angeles.

We seem to have, at least at this point in time, a consensus that we have an economic concept of market power, and it is the ability profitably to price above competitive levels for a significant period of time, and I know that for crystallizing that definition, one of the people we really have to thank for that is Greg.

Another question that I think I was asked to address is what is the difference between monopoly power and market power? Now, syntactically, "monopoly" sounds like -- it says, well, how can you have monopoly power unless you have complete control over a relevant market? You must have to have a 100 percent share of a relevant antitrust market that is surrounded by entry barriers. I suppose -- I do not know, I didn't look at a

dictionary, I should have -- you could say that is it.

That is certainly not the case law definition, and I think, again, within the current antitrust community, nobody would doubt that. I think the right answer is that it is the same as market power. There are some cases out there where there is noise in the opinions that suggests that there is some kind of difference between market power in monopoly power, but it does not seem to make any sense. That is, market power and monopoly power and antitrust law are and should be synonymous. They can occur in various degrees, but they are qualitatively the same.

Of course, the analogy that came to my mind was basketball. I am supposed to leave here tonight and play in a basketball game. Yes, you can tell by looking at me I am our team's power forward, and monopoly power and market power are the same in the same sense that a shot is the same. It goes in or it does not go in. It goes in the basket or does not go in the basket.

Now, some are worth one point, some are worth two points, some are worth three points. You could have lots of market power or little bits of market power, but it is the same thing. It is not like being tall. You could be very tall or not very tall or sort of tall, but -- no, this is like shots in basketball.

I guess I have waited long enough for some wag to say, "Well, what about goal tending?" The answer to that, "If you figure that out, you have got the whole rationale for the per se rule," but you did not want me to talk about per se rules? Okay, I will go to the next thing.

Market power, monopoly power, are really the same thing. They are qualitatively the same thing. We mean the same thing by it. It is helpful to distinguish between I think two types of market power. The DuPont formulation that is quoted a lot is that monopoly power is -- DuPont is the same one that introduced the Cellophane fallacy -- the power to control prices or exclude competition.

That sounds like it is two things, doesn't it? Power to control price or the power to exclude competition, arguing it is really the same, but the reason you see that or the reason you sometimes see this noise in the cases about there are these different things is that the intuition the judges have is that it might make a difference what kind of market power you have or how you are exercising it. We put names on them in the paper, but I do not have to use names.

One way to exercise market power is by restricting your own output, cutting your own output,

sometimes in concert with that of other people in the market who are happy to join with you. I would call that collusive market power. We called it Stiglerian in honor of George Stigler because it is the kind of market power he wrote about.

The other way that one might exercise market power is not by restricting one's own output but by restricting rivals' output, letting market output decline and letting your price rise through no restriction in your own output. That I would call exclusionary market power or market power obtained or exercised by exclusionary means. In the paper we called it Bainian, after Joe Bain, an economist who had written a lot about entry barriers and exclusionary issues.

My second submission to you is that -- while market power and monopoly power are the same kind of concept and that we do have a notion of what it means that we tend to agree on -- that it will help us if we distinguish between whether we are talking about collusion or exclusion, or if you like the little labels, Stiglerian or Bainian market power. Now, why is that the case?

The article is about market power in antitrust law. We are here talking about section 2. So, let me try to explain with respect to section 2 cases, monopoly

or attempted monopoly cases, why it might make a difference to think about the source of the market power or the type of market power that we are talking about.

Point one, market and monopoly power include the power to keep prices from falling to competitive levels. I do not think we forget this a lot. We usually just say it is the ability to raise prices, but when confronted with the ability to keep prices from falling, we usually recognize that as market power, but you should in case you did not.

If you had a horse and buggy industry that was perfectly competitive, a hundred firms each producing 1 percent of all horse and buggy output, if they managed to exclude one firm and that firm was the first firm that was going to produce the automobile, they have nevertheless exercised market power even though it was a completely competitively organized industry. It is market power. It is market power to be able to keep prices from falling to competitive levels. Fencing out rivals who have the ability to bring in a new technology or simply be able to produce products at a much lower cost is an exercise of market power.

Secondly, and connected to that, I believe it is not correct to insist on a threshold showing of market power if the conduct complained of is acquisition and

exercise of market power by excluding rivals. If you are talking about a section 2 monopoly case, and you are saying what they are going to do is restrict their own output and profitably price for a long time above competitive levels, it is probably correct for the reasons that Simon and Miguel have already talked about -- although it was not the principal purpose of their talk, but they explained it -- to insist on some kind of threshold of market power. It is kind of hard to imagine how a firm with only 40 percent of the market can restrict its own output profitably for a long period of time and thereby price above competitive levels all by itself.

That is not true if you are talking about exclusionary behavior. Exclusionary behavior can create the market power. You do not necessarily need to already control a market in order to be able to engage in exclusionary behavior that winds up creating effective market power. You might still have a threshold.

If you do the math, he said -- referring to other people because he is not a mathematician -- but if I understand the literature right, the raising rivals' costs literature, you may want to have kind of a threshold that does have to do with size, like relative

disparity in size. It is unlikely that a firm that has got 5 percent of the market is going to be able to, through exclusionary tactics, drive out rivals who are two and three times as big if it were the smallest firm in the market, but to say that one needs to have a kind of a dominant firm presence before one could ever be tagged with the offense of monopolization under section 2 is just not right unless you are -- because you appear to be forgetting what I've called Bainian or exclusionary market power.

A third lesson from this that is relevant to section 2 cases, I think, is that it seems to me that we frequently hear it said that the mere exercise of market power is not prohibited by antitrust, and I think there is a statement to that effect in the Trinko decision by the Supreme Court a year and a half ago. Indeed, if I recall correctly, Justice Scalia not only said it, but he said you sort of welcome that kind of behavior because it is a signal to people to come enter the market. There are high prices. You can come in and do something. There is nothing wrong with exercising market power if you have got it. The question is how you got it.

Well, once again, I think that probably is true for collusive or Stiglerian market power. It is

probably correct that a firm that has got 90 percent of the market, if they acquired it lawfully, to say that when they raised -- when they restrict output and raise price, that is an antitrust offense, that is a very tough nut to crack, a very hard argument to make, because what are you going to do about it? What is your remedy? How are you going to decide whether they raised price too high?

But if you have in mind the possibility that you might be talking about a section 2 case based on exclusionary market power, it is just not right, because you would attack the exclusionary act, and sometimes you can distinguish between the exclusionary act and other types of behavior with respect to the market power. The most obvious example would be, I think, if I could build off Miguel's example.

He gave that terrific example of the industry where, when you first looked at it, you might think dominance, and then you find all these other aspects here. If this had been an industry in which the issue had been an exclusive dealing arrangement that was having the effect of denying vital inputs to rivals, not only does it not require, in order for that to be a successful antitrust strategy, that the firm have a dominant share to begin with, but it is also not the

case that if it has got a position of dominance, if it is a monopoly, that then the mere exercise of monopoly power is permissible. It is not the case at all, and, indeed, that is an area where I think the European law is ahead of ours, because it clearly reflects that is the abuse of dominance.

Finally, I had one more. It is relevant to antitrust law, but it is not relevant to the Federal Trade Commission or the Department of Justice. One of the lovely things about working for the -- there are many nice things about working for the FTC and the Department of Justice that I think, you know, the most are that you always think you are on the right side and you have these wonderful people to work with, but another thing is you never have to worry about standing, because if you see something wrong out there, you can go after it.

Out in the private sector, you have got to have standing, and I think another lesson that you learn from distinguishing between these types of market power or these types of means of acquiring or exercising market power is relevant to competitor standing. Competitor standing should not be an issue in most section 2 cases involving Bainian or exclusionary market power, because the action is actually targeted at the competitor.

On the other hand and for the same reason, consumer standing, even though the person who may suffer the effects is the consumer, consumer standing may be quite risky, both because there is a more direct subject of the harm, that is, the competitor, and therefore, there is the risk of double damages, and so following things like Associated General contractors and Illinois Brick, consumer standing in monopoly cases may be difficult, and consumer standing in attempted monopoly cases I don't think the Supreme Court has ever addressed it, but there is a growing body of case law in the lower courts now that consumers just do not have standing to bring attempted monopoly cases.

Most section 2 cases are these Bainian exclusionary power type, and you can see the reason for that is that the harm is not directed at the consumer, and if it is merely an attempted monopoly, there is no follow-through on the part of the consumer.

Well, enough for that commercial. Again, I have tried to suggest really just two things to you. One is that we have a concept of market power that we are at least presently comfortable with, and that is no different from the notion of monopoly power for the same reason that we are comfortable with the conception of market power. We are talking about what is the goal of

antitrust, what are we trying to target our antitrust rules to do, and it is to prevent undue concentrations of power where power means the ability to profitably price above competitive levels for a significant period of time.

Secondly, that it will help to keep your eye on the ball, to dig a little bit deeper and say, are we talking about market power that is going to be manifested by restricting one's own output, either by one's self or in concert with one's competitors, or are we talking about market power that is going to be manifested or acquired by driving one's rivals out of the market and thereby gaining the power to exercise higher prices without necessarily restricting one's own output? I think it has a number of potential lessons for section 2, and maybe we will explore some more about that as we talk through the questions.

MR. WALES: Thanks, Tom.

(Applause.)

MR. WALES: Okay, next up we have Irwin Stelzer. Irwin is a Senior Fellow and Director of Hudson Institute's Economic Policy Studies Group. Prior to joining the Hudson Institute, Dr. Stelzer was Resident Scholar and Director of Regulatory Policy Studies at the American Enterprise Institute. He also is a U.S.

economic and political columnist for The Sunday Times and The Courier Mail, a contributing editor of The Weekly Standard, and a member of the board of the Regulatory Policy Institute at Oxford, a member of the Advisory Board of the American Antitrust Institute, and adviser to the U.S. Trade Representative.

Dr. Stelzer founded National Economic Research Associates, NERA, and served as its president for many years. He also served as a Managing Director of the investment banking firm Rothschild, Inc., and Director of the Energy and Environmental Policy Center at Harvard. His academic career includes teaching appointments at Cornell, the University of Connecticut and NYU. He has been elected a visiting fellow at Nuffield College, Oxford, and he is a former member of the Faculty of Practicing Law.

DR. STELZER: Thank you very much. Can you hear me in the back? Thank you for inviting me to this, although I fear I may be sailing under false pretenses. Let me clear up one of them. Although I am at the Hudson Institute, I do not want to appear here as somebody who is a disinterested scholar. I do have clients, some of whom are accused of being dominant, others of whom think dominant firms pick on them, but my views go back before most of you were born. I, too,

still play basketball, but I have learned a trick, which is I yell "Get that rebound" to other people.

I am going to leave any comment on specific cases to my co-panelists, because they are more familiar with them than I. I will say, if I am permitted one vignette, I gave up trying to be involved in specific cases when I was sitting on a witness stand in Tucson, Arizona, and the judge summoned counsel to the bench and said, "We have to talk about schedule." The first lawyer said, "Well, you know, my daughter's getting married in May, and that's going to tie me up." The other guy said, "Well, you know, in June, I really was planning a fishing trip." The judge said, "Well, September, I cannot really do," and so they put everything off about a year. In the middle of this, I said, "Can I tell you something about my schedule, Your Honor?" He said, "Don't be ridiculous." I suddenly realized three lunatics were deciding how I was going to live my life for the next year, and I am not doing this anymore. So, I speak to you as a person who used to testify in these cases.

I have submitted a much longer, unconscionably long paper, which I assume is available to those who want it, and I will therefore restrict my comments to a very few, and also, I want to try out ideas. I am not

wedded to what I am about to say. I assumed we were here to try out ideas, not to hand down edicts, and I thought that is why I would try concentrating on pricing practices by dominant firms.

Simon Bishop said if you are dominant the practice is questionable; my feeling is if the practices are questionable, you are probably dominant. Simon says he is a bit more humble than doing away with market definition. Those of you who have ever tried to do any market definition know that only the non-humble would attempt the elasticity measurements and the other things involved in it. So, the notion that we must begin with market definition because that is somehow a constraint, and anybody who has read any decisions of the EU knows that it is a very, at best -- you defined it as a loose constraint. I think it is looser even than that.

I am not certain that going through the agony of market definition gives you a degree of precision, some sort of constraint on the examiner. It may, but given -- if you go through it, I am not so sure that beauty is in the sight of the beholder as with any other part of economic analysis. I am not wedded to market definition, and I would like to explore the possibility that we might want to do away with that exercise altogether in deciding about dominance.

I recognize that that would unemploy half of the economics profession, leaving only that part that knows about exclusionary practices still existing, but I do think we should think -- think -- about the possibility that defining relevant markets, defining product characteristics, all of that is a kind of very elastic process that we could do away with.

Let me suggest instead -- and I really mean suggest. There is this kind of academic politeness about "let me suggest," meaning "I really know that." I do not use the language that way. I really mean to suggest that we consider that it is the practices that reveal dominance and not dominance that reveals the practices.

I have read some of the proceedings, and it seems to me there is a great deal of sort of motherhood and apple pie stuff in this record. It is certainly true, we do not want to prevent vigorous competition that results in lower prices to consumers. Who would want to prevent vigorous competition? Certainly Microsoft did not want to prevent vigorous competition, it says. Yes, we want firms to develop pricing plans that benefit consumers; yes, we want to give businessmen as much certainty as possibility; and yes, we want to reduce the role of lawyers in the board room and leave

it to businessmen. But I do not think that means that pricing practices should be unscrutinied by antitrust enforcement authorities regardless of any finding of dominance.

What we do not want to condone is long-term harm to the competitive process, therefore to consumers, by approving short-run price reductions aimed at creating barriers to entry or preserving market positions that are unrelated to efficiency. Now, again, I would not try to measure efficiency of a firm, because I do not think I know how to do that. There may be people who know how to do that, and when people say to you they are going to measure costs, they are going to compare costs, I would urge any one of you who agrees that that is a terrific idea to determine any cost of any large firm, and you tell me what range you think would make you feel comfortable in that determination, especially since you are usually dealing with someone who does not want you to find out, and so I think you are going to have a very difficult problem.

What you have to do is examine a firm's pricing practices in the context of the firm's total behavior. You cannot look at a thread in a tapestry in order to get a picture of whether or not a firm is engaging in exclusionary practices.

I will give you an example. If you had in the record that a firm had offered a million dollars to a customer not to deal with a competitor, you would say, "Well, gee, we can't tolerate that." But it is very easy to manipulate a pricing schedule in a large multi-product firm to accomplish the exact same thing, to reduce the cost of the incremental order to pretty close to nil by simply manipulating the pricing schedules and the relationship of past to future deliveries.

In other words, it seems to me, again, that firms spend millions, hundreds of millions, on discovery in antitrust cases, and the discovery is really discovery that will tell you whether the firm is dominant, whether the firm is engaging in exclusionary practices, with far greater certainty than would any measure of its market share.

I think, also, you can tell -- I hate to use this word because I think it is old-fashioned -- you can divine intent from looking at what discovery turns up. Now, by that I do not mean that the statement by an enthusiastic salesman who says "I just rubbed out the competition in Florida" or something like that should be taken at face value, but I think you can determine the intent of a variety of competitive weapons wielded by a

firm by examining the entire record of its behavior, which brings me to the last question -- I said I would not take my full time -- and that is, has what I just said reduced certainty?

A lot of my clients talk about certainty, they want certainty, so you say, "Well, you want certainty? There are two kinds of certainty you can have. Everything you do is subject to a per se rule. That is certainty. How about that?"

"No, that is not what I particularly had in mind by 'certainty.'"

"Well, the other form of certainty is to say, 'Well, almost everything you do is okay.'"

"Well, I think that is lousy public policy."

Certainty is simply not available in this business. That is it. It is good for the lawyers. It is bad for the businessmen. In making their decisions, they have to listen for counsel and decide what to do about the legal advise they get. It is simply one aspect of the many risks they take, just like guessing at interest rates. Certainty is not there. It cannot be had unless some of the more distinguished members of this panel can give it. I cannot.

Thank you very much.

(Applause.)

MR. WALES: Last, but not least, we have Joe Sims. Joe is a senior antitrust partner at Jones Day here in D.C. His practice is concentrated on antitrust and related areas of governmental regulation and includes litigation counseling, agency practice before state and federal courts, antitrust enforcement agencies and various specialized agencies where competition policy or antitrust issues arise. Joe is a member of the American Bar Association, Antitrust Law Section, and has served as chair of numerous committees on the Antitrust Law Section. He's a Fellow of the American Bar Foundation and a member of the American Law Institute. He regularly writes and lectures on antitrust and related subjects and is listed in The Best Lawyers in America, The World's Leading Lawyers, and Who's Who Legal.

Joe, thanks.

MR. SIMS: Thank you, Dave.

Let me start with a point about my perspective, which will also be true for at least Irwin and Tom. I had the revelation when preparing for this and looking back at some of the older cases that I have been practicing antitrust law for about a third of the time that we have had antitrust laws, which is kind of a scary thought if you think about it, but it is true

nonetheless. A little depressing, too.

During that time, no one has ever confused me, unlike most of these people on the panel, as a scholar. I do not cite footnotes in cases. Sometimes I cannot even remember what a case holding was. I do not write law review articles. I write commentaries, not as eloquent as Irwin's commentaries, but it is a less taxing discipline than law review articles. So, I view my role here as offering the practice perspective. I know Tom is a practicing lawyer, but his scholarship is so impressive that I have always viewed him as an academic at heart. So, I am going to approach what I have to say in that light, focusing not on the theory, but on the practice.

Fortunately, jurisprudence and for that matter economics and antitrust is very heavily fact-weighted. The jurisprudence and the economics almost always take a back seat to the facts, at least in the long run. Antitrust law in the United States, where it is really law enforcement and not regulation, is mostly about the facts and how the facts are presented. This is true whether you are talking about agencies or judges. It is certainly true when you are talking about juries.

Of course, the case law is important. Bad case law is not desirable. It is a good idea, if we can,

which we do now and have from time to time, have competent, intelligent people running the antitrust agencies, but all of that fades in importance to the unique facts at play in any particular case.

During at least my practicing lifetime, we have moved steadily away from what we used to spend a lot of time at, which was antitrust by sloganeering, to more careful analysis of the facts. If you remember, Derek Bok called for more certainty and bright line rules in section 7 cases more than 30 years ago. Well, that actually had some resonance for a while, but that concept was seriously injured by Bill Baxter's Merger Guidelines and probably finally killed by the 1992 edition of the Guidelines. When the analysis focuses on competitive effects and not on market shares or concentration or other slogans, the notion of broadly applicable bright lines disappears.

So, today, in merger cases, we do not really have any clear rules. All the facts are in play. Every case is unique, and while the outcome needs to comport generally with stated case law and regulatory guidance, the operative word is "generally."

This is equally true in section 2 matters. We have come a long way from American Tobacco or Alcoa or even Grinnell, which I was shocked to see was decided

just four years before I graduated from law school. It seems like a very old case, and with some obvious exceptions, like, Aspen Ski and maybe Kodak, the general direction of Supreme Court decisions over my lifetime has been to gradually cabin in the reach of section 2, in significant part by insisting upon a focus on the facts as opposed to reliance on the mostly populist rhetoric about market dominance and relative size that dominated section 2 jurisprudence in earlier times.

A good deal of this, of course, reflects the fact that our markets have matured -- that many more markets today, maybe most markets, are truly contestable, which was not always the case -- but nevertheless, we do not have very many clear rules in section 2 today.

I think this is generally a good thing, but it does, as Irwin pointed out, inevitably carry with it uncertainty of outcomes in particular cases. I noticed in looking back at some of the earlier hearings that the Microsoft representative, perhaps understandably, took the position of wishing that there was more clarity in the law. It is a common business position. I think it is a short-sighted business position.

To pick up on Irwin's point, if we really did have more clarity, we would have more restrictive rules.

I do not have any doubt that if you have to choose between clear restrictive rules and clear unrestrictive rules, it is where that line would be drawn. I do not think that would be useful for the public interest in the long term, and it would not even be useful for business at least in the medium to long term. It would make the advisory job easier, but that is about it.

So, with this context, these kinds of hearings are really a great idea, especially if they try, as I think they have, to take the long view of an important area of law. More discussion will produce more understanding and will also demonstrate, as these hearings pretty clearly have, that there is an enormous variety of views on section 2 jurisprudence and policy. Indeed, I would argue that this might be more true today than it has been in my practicing lifetime.

We still have, of course, the strong populist supporters of very aggressive section 2 enforcement. We still have plenty of conservative "let the market work" advocates. But we also today have an incredible variety of economists and law professors and others who articulate an amazing range of interesting approaches to the identification and analysis of market power. Tom Krattenmaker and Steve Salop obviously are responsible for maybe the single most visible effort in this field,

but there are a lot of people keeping them company with new and interesting ideas, including, of course, Greg Werden and others on this panel.

So, there is no end to possible options for new section 2 approaches, but there is also clearly no consensus on any particular approach, with the possible exception that we really ought to pay attention to the facts. It is very hard for me to imagine how we can productively create clear rules or safe harbors for section 2 using market shares or, for that matter, anything else. Given this lack of consensus on where we ought to draw the lines and the truism, that, at least over the long run, markets are a lot better at identifying and responding to consumer demand than courts or regulators or most academics, the chances of finding consensus bright lines that really do advance the public interest are pretty low. But it is nonetheless worth talking about, and so these hearings are a good idea.

Any legal discipline like antitrust where the operative legal standard is in one form or another the rule of reason is going to be messy and unpredictable. Facts are highly variable, and their perception and analysis by humans is even more so. There is the additional problem that courts and regulators, even very

thoughtful ones that take the time to think about and listen to various points of view, are inevitably better at evaluating the past than they are at predicting the future. They are too often focused on fixing yesterday's problems without really having a very clear picture of how that is going to affect tomorrow.

Because of this, we ought to try to be cautious about interfering with markets, doing so only when we are pretty darn confident that the intervention will make things better. I have written on this for 25 years, describing (in very gross and simplistic terms, of course) the two basic approaches in antitrust as "do no harm" and "can we help". The "can we help" school tends to be a lot more confident about their and a court's ability to improve market performance than I am, but the "do no harm" school has been in clear ascendency in the past several years, both at the federal agencies and at the Supreme Court.

This certainly does not mean that it would not be great if these hearings could find a way to produce some clear consensus and let us feel comfortable in drawing some more bright lines like we have in the per se rule against price fixing, or in the section 2 analog, the below-cost requirement for finding predatory pricing. But my reading of the results so far -- and I

have read at least summaries of all of the hearings -- does not leave me with the impression that we have yet identified that consensus.

As I said, I am not sure this is a bad thing. One of the most important -- maybe the most important -- reasons the antitrust laws have continued to serve us so well after more than a century is that they are pretty darn flexible. Congress, of course, passes a lot of statutes where, in effect, buck the problem to the courts or a regulatory agency, but it rarely works as well as it has in this field.

I think that is because, in general and over the long term, the rule of reason is a pretty accurate description of what courts really do -- and regulators too, for that matter. They generally try to figure out what is reasonable under the circumstances with a strong bias most of the time -- let's put the Robinson-Putman Act to the side as an outlier -- toward leaving markets free to work their magic.

As long as this is the operative legal regime under section 2, we will have uncertainty about particular cases and there will be uncertainty about how a particular fact pattern is analyzed. This approach has costs, of course, including, most importantly, the inadvertent deterrence of procompetitive behavior, but I

suspect the costs are less than would be the case with either bright line rules that miss the mark or impractical tests that over-deter because of ambiguity.

So, I do not think we really need a whole bunch of new rules; nevertheless, if we could come up with them, we should, and so I am glad we are looking at it. We have to remember, however, that there is a difference between section 1 and section 2 and a very good reason for the difference. Section 1 deals with joint conduct, and while there are many times when joint conduct can be neutral or procompetitive, there are obvious and very real circumstances where there are competitive risks from joint conduct, cartel behavior being the most obvious. Given this, it is tolerable to have some potentially overreaching penumbras of illegality, although as we get more cases like Daugher, even this is gradually reduced.

But Section 2, by contrast, is aimed at unilateral conduct, and over-enforcement here would threaten the very essence of competition. We want firms to be monopolists or to try to be monopolists. The less risky we make that effort, the less aggressively firms will try. So, section 2 cases should be hard to bring; they should be harder to win. Successful cases should be rare, because true monopolists with durable monopoly

power are rare as determined by how hard it is to name some. It is kind of hard to do, actually.

That's why Microsoft was such an attractive case. It was one of the few instances where you could look at it and say, "Doggone it, it looks like they do have a monopoly." If we can devise some rules or guidelines to help us advance this cause, that is great. My guess is we cannot, so we ought to let the market -- in this case, the market for judicial decisions over the long run -- create and enforce the rules, and the result will be just fine.

Thanks.

(Applause.)

MR. WALES: Thanks, Joe.

Okay, as we said, we are going to take a 15-minute break. So, why don't we reconvene at 3:35. Thanks.

(A brief recess was taken.)

DR. WERDEN: Okay, let's get started again.

What we are going to do for the next little while is start by putting one or two questions to each of the speakers, in turn, and then letting the other panelists, if they like, comment on what has been said, and we are going to take the panelists in the order that they spoke, so I am going to start with Simon, and my

question, Simon, is, while there is clearly a dominance threshold under Article 82, there really is an open question as to how high the bar is for dominance, and I think the way Miguel described it, the bar is and ought to be quite low. What do you think about that?

MR. BISHOP: Okay, well, contrary to what Irwin might have suggested, most of my clients are actually dominant firms, so on that basis, I think, you know, the 40 percent threshold, which is enshrined in Article 82, is a pretty reasonable threshold to have. I mean, if your market share is below 40 percent, then you can do whatever you like. If you are above that, then we move into the effects and the assessment of the behavior under consideration. It does not mean if you are above 40 percent, what you are doing is necessarily anticompetitive.

DR. WERDEN: But you wouldn't say that all the firms above 40 percent are dominant, of course, would you?

MR. BISHOP: Absolutely not, and that is why I said in my talk, you know, the market share is only one factor. You have got to take into account a lot of other factors to assess whether that 60 percent, say, is representative of significant market power.

DR. WERDEN: Do any of the other panelists wish

to offer a view as to how high the bar should be set in the United States where I think most observers think it is set considerably higher than in Europe?

MR. KRATTENMAKER: Or whether there should be a bar at all, I guess.

MR. SIMS: But, Tom, wouldn't you say that there shouldn't be a bar, I would think?

MR. KRATTENMAKER: Yes.

MR. WALES: So, the answer is there is no bar.

MR. KRATTENMAKER: Or what I would say is, bar to what?

DR. WERDEN: Bar to proceeding.

MR. KRATTENMAKER: You mean, like, a post-behavior section 2 case where the claim is what I called collusive or Stiglerian power? Sure.

DR. WERDEN: Well, if you want to go down that road, in an actual monopolization case, where the defendant is alleged to have acquired a monopoly, the courts have set the bar fairly high on what it means to have a monopoly and generally have required, in fact, a 70 percent share protected by pretty high barriers to entry.

MR. KRATTENMAKER: Yes, right, right. I think if they acquired that monopoly by, for example, acquiring a lot of rivals by purchasing firms, that

would probably be an appropriate threshold to do. Now, you do not see cases like that because we have had section 7, so almost all section 2 cases now are what I would call exclusionary or Bainian type, and yeah, that is right.

I think it is not correct to say you could not possibly have market power if you have got 66 percent of the market.

DR. WERDEN: So, in the Microsoft case, if their share had been 10 percent, you would have looked on things pretty much the same way?

MR. KRATTENMAKER: You know, there were so many facts at issue in the Microsoft case...

No, as I tried to indicate, it does not seem to me that you utterly disregard market share, Greg, but as I understand it -- and I am still learning this area -- the ability to exclude can oftentimes be a factor of relative size, but the idea that it requires dominance of the entire market I think is quite wrong.

DR. STELZER: Given what Microsoft did and proved itself capable of doing, did you have to bother measuring its market share? I mean, nobody who didn't have huge market dominance, i.e., 90, 80, 40, could do those things, could make an equipment manufacturer pay them for stuff that was not in the machine. I mean, you

have got to have an awful lot of market power to do that. You want to measure market power because lawyers make you do it, but as a matter of policy, in the case of any firm that can pull off what Microsoft pulled off, you could skip the whole market share measurement stuff and just say, if they did this, they have market power, they have abused it.

MR. KRATTENMAKER: I probably ought to let Joe pick up on that, but I will say -- I mean, I know a little bit about Microsoft. I mean, you might be able to say that, but if what you are doing is talking about the part of the case where they allegedly misrepresented whether their programs -- either how it interfaced with Java, I do not know that you needed to have a dominant market share in order to lie.

DR. STELZER: No, no, I was talking about where, if you decided to put a competitor's product in the machine, they charged you for each machine whether you put their stuff in it or not.

MR. KRATTENMAKER: No, I've gotcha. I take it -- I mean, I am sympathetic to your viewpoint, but it is conduct-specific. For certain kinds of conduct, you might infer market power from the fact of the behavior.

DR. STELZER: What they do, I shall know them.

MR. SIMS: On this point, I am more with Tom

than Irwin, I think, surprisingly enough. Market definition and whatever you draw from that market definition is a tool that you want to use when it is necessary and useful to figure out what the competitive effects of the conduct at issue are. So, there are some times -- and Microsoft might well be a good example -- where, careful market definition is not all that important.

MR. BISHOP: But I think, I mean, some of the difference between the U.S. people at that end of the table and the Europeans down here is really -- sort of reflects some of the sort of philosophical, institutional differences, and I'll say institutional because I think my personal philosophy is going to be closer to that end of the table than a lot of Europeans, and I think that that is a point which Joe talked about, you know, is do no harm, which is, you know, very much a high threshold before you would start intervening, then sure, maybe you don't need a market share bright line test, but in Europe, the institutional philosophy is much more -- you know, there are a lot of markets, the EU, the Commission or the competition authorities can intervene in to make things better, and in that situation, in that sort of institutional setup, then having a bright line test which says, "If you do not

have a market share of above 40 percent or whatever, you can do whatever you like," seems to me an important safeguard to prevent people coming in and start messing around with your industry, which is very costly and potentially extremely disruptive to the firm's business model if that firm has got no market power at all.

DR. STELZER: But that is kind of the "stop me before I kill again" argument, right? You need -- because you know that you really could be irresponsible and do bad things, you better have some sort of rule that stops you from doing it on the theory that the rule, is the lesser of the evils. It is a substitute for judgment.

MR. BISHOP: No, it's not. It is a substitute for deciding when a competition authority can bring an action against a business.

DR. WERDEN: Or in the United States, substitute for a jury trial.

MR. SIMS: Well, there is that pretty critical difference between the U.S. and Europe in that in Europe, the Commission generally gets to say yea or nay, and in the United States, the FTC and the DOJ never get to say yea or nay. Unlike the EU, they have to go to a court and convince a court.

I think what Simon is postulating is that some

kind of -- if I could borrow the word -- durable guidelines that, would last beyond a particular administration of the Commission and thus constrain the current occupant of those decision-making positions is a good substitute, partial though it may be, for what we have here in the courts.

DR. WERDEN: Okay, that was fun. Let's move on to a question for Miguel.

I was very intrigued by your very clear point that the suspect conduct in an Article 82 case cannot itself be what creates the barrier to entry that is required, in turn, for the firm to be dominant, so that if it was possible to have a firm with a whopping share protected only by the suspect conduct in the case, otherwise you would be flooded with competition, then that firm isn't dominant? Is that your submission?

MR. de la MANO: Indeed, and there is the problem that we have in the EU, that we do not really have a standard which allows us to pursue attempted monopolization.

DR. WERDEN: No, let the firm be 80 percent. It is 80 percent, but the only thing keeping out competition is this guy's anticompetitive conduct. Now, the guys at the end of the table would go after this guy at 5 percent it sounds like, but let's put that aside.

He's 80 percent, and he's doing bad stuff, and he's keeping the competition out. If he didn't keep doing the bad stuff, the competition would come in. They might even swamp him.

MR. de la MANO: So, let me now link that question to the previous question to Simon, which is where should we put the threshold for the finding of dominance, and, of course, Simon has argued 40 percent might be a good place. I am not sure it is a good place, and there are a number of reasons why 40 percent might be too high.

First of all, dominance is going to be a necessary requirement, and in some cases, like the situation you just presented, it may well be that if the practice is preventing entry in the market, but in assessing dominance, what we are ultimately assessing is the situation without such practice. That's why dominance is a screen. In a case like that, it would not be possible to be brought forward by the European Commission.

Now, that clearly -- you might say, "Well, that's wrong," and that's why you have attempted monopolization in the U.S. and we do not have it, but a second reason why if dominance acts as a screen, we have to be very careful in not setting the market share

threshold for a finding of dominance far too high.

There is a third reason, which is, as has already been highlighted by Simon before, which is market definition is an imprecise exercise. Now, I think everybody here will argue that in some cases, if a company has a share slightly above 40 percent, slightly below 40 percent, you know, it probably doesn't make much of a difference, but if you have a threshold at 40 percent, it is critical.

So, even though in practice, a firm with 35 or 45 percent is probably likely to have much more -- the same kind of market power, in theory, this is a threshold at which it either -- the Commission is going to intervene or not, whereas if you had a lower threshold -- and, of course, market definition is going to be critical there. It is going to determine whether or not the Commission is going to intervene or not. If you have a lower threshold, then the precision of the market definition exercise matters much less, because if you had it wrong and the market definition was actually too narrow or too wide, but you are wedding yourself into the 20-30 percent threshold, it doesn't really matter.

As long as you are below 25 percent, even if you've got market definition wrong, it is for certain,

almost for certain, that there are going to be no problems, and therefore, there should be no intervention whatsoever.

DR. STELZER: To ask a practical question, what makes you look at something in the first place? You go into a bunch of market share studies and you say, "Oops, here's a 40-percenter, I'll go after him"? Or is it some practice that makes you look?

MR. de la MANO: The latter, essentially a complainant would --

DR. STELZER: Simon says no.

MR. BISHOP: Well, Miguel said it right. It is some complainant submits a case.

DR. STELZER: Right. Now, as I understand the EU attitude, it differs from the American. Here my economist friends believe that if the complaint comes from a competitor, it is therefore tainted somehow. It is the use of the legal system as a strategic device. That is different from the EU, and I think the EU is right but is the EU sticking with the notion that the fact that a complaint comes from a competitor does not taint the complaint?

MR. de la MANO: Well, practically in all cases -- probably in all cases that I have been involved in, the complaint has come from the competitor, some

outliers where a consumer may bring the case, but it is very, very rare. When that happens, because we have an opportunistic system, the Commission, of course, has to take in mind the private interests of the complainant and how that might taint their submissions, but ultimately the Commission is obliged to give its decision, whether it is a decision to intervene, and therefore -- and that would be trying an independent objection sent to the dominant company or allegedly dominant company, or there would be a rejection of the complaint, which would be a formal rejection, would be written and sent to the complainant.

So, either way, the Commission basically has to make up its mind, and in doing so, has to definitely take into account to find out if the evidence that has been brought forward to it is submitted by parties which have their own interests at heart.

DR. WERDEN: Tom, I have a question for you. You seem to be saying that the mere exercise of exclusionary market power is a section 2 offense all of the time, but I want to clarify if you mean without regard to the potential of that conduct to create or maintain something we would call monopoly power.

MR. KRATTENMAKER: I do not mean that.

DR. WERDEN: Okay, that's great.

MR. KRATTENMAKER: Thank you.
DR. WERDEN: Anybody want to follow up on that?
MR. KRATTENMAKER: Irwin says no.
DR. WERDEN: Well, say it out loud.
DR. STELZER: But brevity is so much the soul of wit that I hated -- I just preferred to let your answer hang out there.
MR. KRATTENMAKER: Sort of like a beautiful arcing three-point shot that's probably right dead bang through, nothing but the net, exactly, just let it sit there.
DR. STELZER: Right, see, but I play basketball at 10,000 feet.
MR. KRATTENMAKER: Of course you do. You are a good guy.
DR. STELZER: I was trying out ideas. I am not sure. Tom, tell me why you think about that.
MR. KRATTENMAKER: Oh.
DR. STELZER: How, as a practical matter, you would tell in a case.
MR. KRATTENMAKER: Because there is lots of -- because the whole point about the competitive process is to beat your rivals, and so inferring from the fact that practice has an untoward effect on rivals, that it therefore violates the antitrust laws, it is just too --

to coin a phrase -- over-inclusive.

DR. STELZER: Yeah, okay, but -- I guess I was thinking in terms of defending the competitive process, not competitors.

MR. KRATTENMAKER: Yeah, right.

DR. STELZER: And that's harder.

MR. KRATTENMAKER: Well, I agree. I mean, the fact that you inflict some sort of inefficiency on your rival, you could say, "Gee, that's bad, and we ought to stop it," and that's kind of like the Klor's case. That's Klor's against Broadway-Hale. I mean, they might have done something bad, and we could care for less that there were a hundred other stores in that city, and, I mean, there is a way I used to tell that. I mean, I went back to the record and examined that case, and it turns out that the reason that there was this dispute here was that the owner of Broadway-Hale had a ne'er-do-well son who had impregnated and run away with the daughter of Klor's, and this was an alienation of affection suit brought as a Sherman Act case.

Now, of course, that is not true, but I tell that story and the students believe it, and so that's the long way of saying I do not think that section 1 -- of course, we are not talking about section 1 -- was meant to federalize the tort of alienation of affection.

So, not only are you supposed to beat up on your rivals, but not everything you do to your rivals is either necessarily commercially motivated or motivated to drive monopoly profits.

MR. SIMS: And, Irwin, if you don't demand that the conduct have at least a high likelihood of creating durable monopoly power, then you really do have a serious risk of sticking your nose into the market where you are going to do more harm than good, because differentiating between exclusionary practices on some grounds other than whether they have the potential to create durable market power seems to me to be very hard.

DR. STELZER: But you used the term "durable" about five times. What do you mean?

MR. SIMS: I mean more than temporary.

MR. KRATTENMAKER: There you go.

DR. WERDEN: Your turn, Irwin, as if you haven't talked enough.

You seem not to at all be a fan of limiting principles, and I want to push the limit on limiting principles. Are you suggesting, for example, that the Brooke Group rule was a really bad idea?

DR. STELZER: I don't have any idea.

DR. WERDEN: You don't think that in a predatory pricing case, a plaintiff should have to show pricing

below some measure of cost?

DR. STELZER: Oh, no, I think that's ridiculous, and I'll tell you why. First of all, I don't believe you can measure marginal cost. I've spent a lot of time trying to do that.

DR. WERDEN: The courts do not like marginal cost either.

DR. STELZER: I'll take any kind of cost you want. I don't think you can do it. I've been in enough proceedings at regulatory agencies where people are supposed to measure costs to know that.

Second of all, the real question with predatory pricing is not whether the person prices below or at some concept of cost and has a prospect of recoupment, but think of it this way. You are walking along and you want to have a picnic, and there's a sign that says, "No trespassing." You figure, what the hell. You throw down your blanket, you have a nice picnic, and you leave, right?

Now you are walking along and there's another field where you want to have a picnic and there's a no trespassing sign, and there are about four or five corpses lying around. Are you going to have a picnic there? I don't think so.

So, what we are talking about is the kind of

practices that are entry-deterring in the technical jargon, that scare the hell out of people, because remember, this is more and more an age in which the financing of new companies is done by venture capitalists, and if you have ever been to a meeting with a venture capitalist -- these are not very nice people, many of them -- the first thing they want to know is what is the range of practices available to the incumbent competitors to keep you out or to destroy you if you get in. That is what they want to know.

I mean, have you got a good idea? Yeah. Are you a pretty good manager? Yeah. Can I suck most of the value out of your enterprise? Yeah. And then they want to know what are the incumbents going to do to you, and if you go to enough meetings where people describe what Microsoft might do to you or what other companies might do to you, a lot of the stuff we are talking about becomes irrelevant. Entry-deterrence is the problem. Will they cut prices? Yes, they might. Is that okay? Well, that's a tough one. That's very hard.

I know this sounds mushier than you'd like it to be. People who say I am going to measure costs and then I am going to measure market share -- in the Sirius/XM merger, right, they are going to take one data point and they are going to measure cross-elasticities and all

that other stuff? Ridiculous.

So, what I am saying is in a practical world in which new firms are being created, in which technology is increasingly important, in which small businesses and new entrants are the manufacturers of macroeconomic growth, I would lean pretty hard in the direction of being very skeptical about the range of competitive tools permitted to incumbents, to powerful incumbents, for macroeconomic reasons, for microeconomic reasons, and -- dare I say it, even though Judge Bork is a colleague of mine -- for equity reasons.

DR. WERDEN: Are you suggesting that if the incumbent is happily pricing at 100 and somebody has a new idea and comes in and sells it at 80 and the incumbent says, "Well, I better knock my price down to 80 or I am not going to make any sales," he's already in trouble?

DR. STELZER: No, I am saying you have to look at a lot of things. You see, that's the trouble. You are trying to pick out one thing that will tell you what the hell is going on in this industry. You can't do that.

DR. WERDEN: Okay. Well, I concede that I can't do that. So, what do I do?

DR. STELZER: You look at the entire range of

business practices of the company. You look at the durability of its market share. You look at the history of the notices it has posted in the past when competitors try to come in, and you try to make a decision as to whether those were imposing inefficiencies on the potential competitors or not.

MR. WALES: Go ahead, Tom.

MR. KRATTENMAKER: I want to come to Irwin's partial defense now --

DR. STELZER: Oh, God.

MR. KRATTENMAKER: -- on Brooke Group but make a comment about -- to make a comment about what Joe said, too.

On what Irwin said, you know, pricing below cost, I am really not so sure. Recoupment, yes, and the short answer to your question, Greg, is you have got to show that they will be able to get their price back up. When we all sit around and decide that we have this common mantra and we decide to chant it, whatever this antitrust religion is that we have, you have to be careful to think about it once in a while.

Saying it has got to be below the pricing firm's cost is to smuggle in the old efficient competitor rule into the marketplace. If it is the case that the firm can by pricing right down to its cost drive out four

firms and leave us with one firm instead of five in a market, some people may say that drives us to more efficient production, and other people will say that is going to tend to drive prices further away from costs. It depends on which value you think is important in antitrust.

I think it would be better to have a discussion about that than the silly stuff in Brooke Group about what we happen to know because we happen to put on black robes and so we are infallible, that people often try predatory pricing and rarely succeed, a statement which I believe had no support. There might be a footnote there, but it doesn't cite any empirical work.

So, I don't mean to say that I am opposed to Brooke Group, but what I mean to say is you don't look askance at somebody and say, "You mean they wouldn't price below cost?" Irwin is talking about a somewhat different set of values and in this case a very defensible set of values, particularly if you do keep the recoupment link, I would say.

The other comment, I mean, I think this is the right time to make it, I thought Joe had one of the most interesting observations I've heard in a long time about the bright line rules and fact-based rules, and that's exactly what has happened to merger law in the whatever

years since Joe and I first started studying merger law, but it's not what's going on in section 2, and these are hearings about section 2.

You've got some cases that were sort of driven down to fact-based. Aspen Ski is one of those where they looked in the record and found that there were some angry skiers in Atlanta, and Kodak copiers is one of those, but we have some bright line cases, too, Weyerhaeuser, Brooke Group, the 11th Circuit decision in Schering-Plough, that say, do not tell me any facts. All I want to hear is some theory.

So, in section 2, we are in -- I'll shut up here now in a minute -- in section 2, we are at this funny point where we haven't moved to Joe's Nirvana, and I think we need to face that.

MR. SIMS: See, it is interesting. I agree with you on Brooke Group and Weyerhaeuser. Those are essentially safe harbor decisions.

MR. KRATTENMAKER: Yeah.

MR. SIMS: But I would vehemently disagree with you on Aspen Ski and Schering-Plough. I think that Aspen Ski is certainly not fact-based. You can't do a fact-based analysis of Aspen Ski and conclude that there was an antitrust violation there.

MR. KRATTENMAKER: No, the fact they found turns

out not to be a violation -- turns out not to be an anticompetitive act, but --

MR. SIMS: Well, that's certainly true, and I think Schering-Plough I think did focus on the facts, and the fact that was determined -- that was found to be determinative in Schering-Plough was the existence of the patent and the scope of that patent. That's a fact-based analysis to me, not rule-based.

DR. STELZER: Can I ask you something about Aspen Ski, because I am not a lawyer --

MR. SIMS: Sure.

DR. STELZER: -- although I was involved in that case just because I happened to be in Aspen at the time and the plaintiff couldn't afford anybody and I was free.

MR. SIMS: I remember actually visiting you in Aspen periodically.

DR. STELZER: Right. Well, come this summer, because I don't have judges setting my schedules anymore.

Let me ask you something. There was an unchallenged determination of the relevant market.

MR. SIMS: Yes, that was the --

DR. STELZER: Now, is that a fact or is that not a fact?

MR. SIMS: That was a lawyer error, actually. That was a stipulated market which any good antitrust lawyer wouldn't have done.

DR. STELZER: All right. So, we are now down to, if I understood it, it is not a fact if it is determined by a judge and a jury but it is a lawyering error. Is that right? So, that makes it not a fact.

MR. KRATTENMAKER: That's our position and we are sticking to it.

DR. STELZER: Okay, that's all right, I just wanted to know.

DR. WERDEN: Moving right along, Joe, I am not entirely sure I understand your position. I am not sure that you go so far as to say clarity is bad. I think your position more is that hoped for clarity isn't going to come in a useful way, to which my follow-up question is, well, aren't there things like the Brooke Group rule that would form conduct-based safe harbors that might be a good idea? For example, that it is okay to introduce a new product even if that causes your competitor to fail?

MR. SIMS: Well, I wouldn't have any problem with that rule, but I think you'd have a lot of trouble getting broad consensus on it.

DR. WERDEN: I am willing to try. Let's see

what we can do here on the panel.

MR. SIMS: You might find some people that think that's what Microsoft did and does and is doing -- introducing new products that are creating competitive harms; at least I think that's the theory in the EU's current preoccupation with Microsoft. So, I am fine with a Brooke-type safe harbor for new product introductions. I am not exactly sure how you'd set it out so that you left it open for the one in a however many times that might be anticompetitive, but I'd be fine with that. I doubt seriously that you would get broad consensus on that.

My point is that there is not incredibly broad consensus on the Brooke Group rule, which is I think about the only effective safe harbor in section 2 now. So, I am not sure that you would have a very easy time coming up with consensus on any others. I am happy to see you try, and I could come up with a number that I'd be comfortable with, but I doubt that I'd get everybody to join with me.

DR. WERDEN: Well, we can give you 30 more seconds. How many can you give me in 30 seconds?

MR. SIMS: Well, new product design would be fine. I mean, in general, new products and product design decisions, I am involved now in defending Apple

in the iPod tying cases. We shouldn't have to go through all the hassle that we are going to have to go through to get rid of those cases. So, I am perfectly happy with that if you can find enough consensus to implement it.

DR. WERDEN: Do I hear any dissenters?

DR. STELZER: Well, I was just curious, Joe, what about what they call fighting brands in the cigarette industry?

MR. SIMS: What about them?

DR. STELZER: That's a new product.

MR. SIMS: Is there anything wrong with that?

DR. STELZER: Is there anything wrong with that?

MR. SIMS: No, I don't see anything wrong with that. Did it impair competition in some way?

DR. STELZER: It had very negative effects on some of the competitors who made the brands.

MR. SIMS: That's different.

DR. STELZER: But it sends a notice that you are going to come in --

MR. SIMS: Look, I happen to know an awful lot about the cigarette business, unfortunately, because I just did a merger there a couple years ago. There are one heck of a lot of independent sellers of cigarettes in the cigarette business. In fact, they have driven

the market share of the market leaders down, and more importantly, they have taken away a big part of their margin, which is why the FTC decided not to challenge the merger of the number two and number three players.

DR. STELZER: Okay.

MR. KRATTENMAKER: I worked on that case, too, and some of what Joe just said is true.

DR. WERDEN: Probably some of what Joe says is always true; it is a question of how much.

MR. KRATTENMAKER: I was on the other side, I'm sorry, I was doing it for the FTC.

MR. de la MANO: I would defend, Greg, that particular bright line rule.

DR. WERDEN: Okay. When is a new product introduction a bad thing for consumers?

MR. de la MANO: I think that's the wrong way to put the question. I think no bright line rule is going to work unless you define it very, very carefully, and you will --

DR. WERDEN: Of course. That's what your job is.

MR. de la MANO: Well, that's what we found in the new product rule that we were given by the court in the area of refusal to supply, the new product test, that -- it sounds fine in the context of that particular

case, I admit, but we just do not know what's a new product.

DR. WERDEN: Well, but if we are going to take a European approach to this question, then perhaps we should appeal to our ordoliberal traditions where, what we say in English, competition on the merits was a fundamental principle. That was legal without regard to its effect, and there are reasons to believe that this concept is embraced by Article 82.

Now, as far as I can tell, no European court has ever said that that actually means something, but it should mean something, shouldn't it?

MR. de la MANO: Definitely.

DR. WERDEN: Okay, what does it mean?

MR. de la MANO: Well, the problem is that if you put the question in terms of would a new product ever constitute the situation where it could lead to consumer harm, I think the answer is always going to be no. That is competition on the merits. That is a situation where there's going to be traditional value to consumers, that's pretty obvious, but the difficult thing for a competition agency is to define or identify whether that product is, indeed, new, and there are many situations where what might appear on the face of it to be a new product, from the perspective of certain

customers, but is just an extension or an additional feature that's added to an old product, but if that additional feature serves the purpose of preventing entry, then maybe there is a problem.

DR. WERDEN: I agree there's always going to be a fine line, and Irwin correctly pointed out that the fine line is Brooke Group is a serious problem. We can't figure out costs well. But that doesn't mean there's something fundamentally wrong with the principle.

MR. de la MANO: Absolutely not. It's not just a good bright line for enforcement.

DR. WERDEN: You are coming to that decision awfully fast. How long have you been applying it?

MR. de la MANO: I don't think we have had a single case in the IMS where we have actually been able to define a new product as of -- that's a few years.

DR. WERDEN: Of course, the bright line rule there is that you can refuse to license. That solves that problem, doesn't it?

MR. de la MANO: Yeah, solves that one, yeah.

DR. WERDEN: Okay.

MR. WALES: Should we move on to the principles? Go to the first one.

DR. WERDEN: Okay, I hope you people can see

this. We are going to read these.

MR. WALES: I actually have them in hard copies and we can pass them out.

DR. WERDEN: Okay. We are going to read them into the record in any event.

We have in most of our sessions, but not this morning, gone through what we call the propositions where we put up a declarative sentence and ask the panelists whether they agree or disagree and why.

The first one we have here is, "Monopoly power is the long-term ability of a firm to earn greater than a competitive return on investment."

It's not the most orthodox definition of monopoly power, but it happens to be the almost verbatim the definition in one of the leading economics textbooks, and it focuses attention on something that in principle we might be able to figure out, although it's not going to be easy, whether a firm is earning more than a competitive rate of return.

So, Tom, why don't you start.

MR. KRATTENMAKER: I think it is good enough for government work.

DR. WERDEN: Good enough for the courts of the United States of America?

MR. KRATTENMAKER: Not having tried to do a case

under this test, I would want to think some more about whether I'd rather be going and getting evidence about competitive returns than I would about prices and costs, Greg. So, I cannot answer your question. I am obviously -- as a lawyer, I am, of course, hind-bound, I am always looking backwards, and so I am happier with a test that focuses on price than competitive return if you give me 30 seconds to think about it, but --

DR. WERDEN: Well, that's fine. It doesn't say here what the evidence would be, and I think it would be prices and costs in some cases, most cases, but the question then is going to be, what price and what cost?

MR. KRATTENMAKER: Thank you for modifying this as we go. It has changed from long-term to long-run, it has changed from competitive return to pricing above costs. I think it is basically right, but I want to say the devil's in the details, but there are some details that would need to be worked out, but sure.

DR. STELZER: Would you accept --

MR. KRATTENMAKER: As you know, I'd also say that's also market power. I do not know, is that the next question? Do we have another question about that?

DR. STELZER: Can I ask you a question?

DR. WERDEN: Please.

DR. STELZER: Would you substitute cost of

capital for competitive return on investment?

DR. WERDEN: Possibly.

DR. STELZER: Okay. Have you ever been in a utility case where they're determining the cost of capital?

DR. WERDEN: We hardly ever do that anymore, thank God.

DR. STELZER: You hardly ever do it, but if you walk down the block, there's a lot of people doing it. There's economists doing it all the time and there's a huge dispute about it, but I think cost of capital is at least more precise as far as the literature goes than a competitive return on investment. So, if you want to play with this, I think you should do it in terms of cost of capital, because there are all sorts of ways of measuring cost of capital, and no one will know -- they won't know with as much precision what you are talking about when you talk about a competitive return.

DR. WERDEN: Well, coming back to Tom's question, if you want to put this in terms of prices and costs, the question, as I said, is what price and what cost?

MR. KRATTENMAKER: Sure.

DR. WERDEN: And in particular, the difference between monopoly power and market power, it is

conventional, at least, although there are some dissenters, to define market power as the ability to price above short-run marginal cost, but hardly anybody would say that the right definition of monopoly power is the ability to price above short-run marginal cost, because that would give us too many monopolists.

MR. KRATTENMAKER: I think your second sentence is correct and your first sentence is wrong.

DR. WERDEN: So, what is the definition of market power?

MR. KRATTENMAKER: I believe that market power has a durability component as well, the last time I read the Guidelines, nontransitory.

MR. WALES: So, shorter, Tom, is that the point? It is shorter than monopoly power?

MR. KRATTENMAKER: No, it is the same.

MR. WALES: So, both qualitative and quantitative? I guess you made the point that qualitatively, they're the same, but are they also quantitatively the same?

MR. KRATTENMAKER: Oh, I think each of them comes in degrees, Dave, I'm sorry. To go back to my metaphor -- they could turn out to be a one-point shot, a two-point shot, a three-point shot. I don't think it would serve us any value to say, well, if it is a

two-point shot, it is market power, and if it is a three-point shot, it is monopoly power. I don't -- as a matter of moving the cases along, I don't see the point.

DR. WERDEN: Well, let me put the question, then, doesn't it make sense to have a significant threshold in a section 2 case that is different and higher than the threshold of market power in a section 1 case? And don't the cases pretty much say that's the law now?

MR. KRATTENMAKER: No. Yes.

DR. WERDEN: Okay, at least that was clear.

MR. BISHOP: But, I mean, the European perspective, I mean there is some debate in Europe about whether we can characterize firms which are dominant and those firms which are super-dominant, which is sort of, you know, similar to this, and my sense is that, you know, why bother introducing this new term, you know, "super-dominant"? If we are just going to use the dominance as a threshold step to deciding whether we need to investigate in more detail the competitive conduct, whether a firm is dominant or super-dominant doesn't really make any difference in that decision.

DR. WERDEN: Okay, let's move to the second proposition. I think Joe spoke precisely these words, and I want to see how much consensus we have on the

proposition that monopoly power is rare.

MR. WALES: If we can go back to Miguel.

MR. de la MANO: Well, in line with any consensus that monopoly -- it makes very little sense to distinguish between market power and monopoly power for the reasons that have been explained on both sides of where I am sitting, I would say monopoly power is fairly common. The key question is, however, how much of it do you really need to show or need to have before you decide to investigate any further? Being shown monopoly power is not anything in itself; it is the practice itself, the conduct.

DR. WERDEN: I think you have identified one of the major differences in attitude between the European school and ours. Our courts are really hard sells on the subject of monopoly power. It is an empirical fact that it is very hard to convince a court that a firm has a monopoly in the United States, and it's not that hard, it seems, in Europe.

I think you have already cast your vote that it is probably too hard in the United States. Anybody else want to weigh in on that?

MR. KRATTENMAKER: Well, yeah. I mean, I think that Miguel has really laid his finger on it. If we then say that you possess market or monopoly power if

you face a downward-sloping demand curve, I think it may well be that many, perhaps most firms, do, but the second thing I was going to say is this question, monopoly power is rare, is exactly why I went to law school instead of graduate school in economics. You have to ask an economist who does not I/O theory, but I/O reality, how often this happens. Isn't this what Joe Bain spent his life trying to do, but --

DR. WERDEN: I don't think so, but --

MR. KRATTENMAKER: Okay.

DR. WERDEN: Anyone else?

MR. de la MANO: Can I reverse the question?

DR. WERDEN: Rare is power monopoly?

MR. de la MANO: No. Do you think contestability of a market is rare?

DR. WERDEN: I think it is unheard of.

MR. de la MANO: Well, there you go.

DR. WERDEN: I am not sure where I am.

MR. BISHOP: How does that follow?

MR. de la MANO: Well, it follows that if contestability is the opposite of monopoly power and contestability is unheard of, it must be because most firms have market power.

DR. WERDEN: Well, but then you are equating market and monopoly power, and I am not buying into that

one.

MR. de la MANO: Okay.

MR. BISHOP: And I guess it also relates to entry to a market. You can have firms with high market shares subject to effective competitive constraints because the small rivals could easily expand.

DR. WERDEN: Okay, a third proposition, and this is something that Simon already said. "The Cellophane fallacy likely does not apply in attempt to monopolize cases." Of course, he didn't use that language, because that's American language, but here we have an offense of attempt to monopolize in which the defendant doesn't start out dominant, but it is alleged that he would end up dominant with a dangerous probability through the activities that he's engaged in, and in defining the market in such a case, the proposition is that the Cellophane fallacy probably isn't a problem.

Simon I think already said yes, that's true. Do we have any other views?

MR. BISHOP: Easy one.

DR. WERDEN: I think that's an easy one. I like easy ones.

Next, "When the Cellophane fallacy does apply, which is not a significant number of cases, the proper benchmark price in market delineation is the market

price absent the challenged conduct, which is normally not the competitive price."

It is often said, perhaps rashly and wrongly -- we are going to find out -- that you should go down to the competitive price to do the market definition analysis. This proposition says no, you should look at some kind of but-for price, and Simon, what do you think about that?

MR. BISHOP: Interesting theoretical question. The answer is sort of, maybe, but I think in the sort of practical reality, it makes no difference. You don't know what the but-for price is; you don't know what the competitive price is.

DR. WERDEN: As a practical matter, you may be exactly right, but let us suppose you could actually figure these things out. What would you do?

DR. STELZER: And if my grandmother had wheels, she'd be a bus.

MR. BISHOP: If you think about these things, then all we need to do is be concerned with the Cellophane fallacy or anything. The whole antitrust would be very, very easy.

MR. SIMS: And that is how we get ourselves into the messes that we get ourselves into, is pretending that we can ignore reality.

MR. KRATTENMAKER: I think this is a very interesting concept, and it might be right, but I didn't understand the earlier question, and I don't mean this as a challenge, Greg, but if you -- if we know both the market price absent the challenged conduct and we also know the competitive price?

DR. WERDEN: Yes.

MR. KRATTENMAKER: And you are making two statements, which is that those are normally different --

DR. STELZER: Right, and then which is the benchmark?

MR. KRATTENMAKER: And then I would choose one?

DR. WERDEN: Yeah. I am not saying these things are easy to figure out. They are not. I agree with Simon.

DR. STELZER: They are impossible. It's not that they are not easy.

MR. KRATTENMAKER: I am only clarifying the question. The question assumes that I know these two prices that are in here, and so you are asking -- you are making a statement and asking us about a statement and a value choice.

DR. WERDEN: I'll let you know everything that you'd like to know.

MR. KRATTENMAKER: Okay, I know the market price absent the challenged conduct, and I know the competitive price, and I know that the market price absent the challenged conduct is higher than the competitive price.

DR. WERDEN: Yes.

MR. KRATTENMAKER: Simon's the expert, but I'd be inclined to say that the right answer whatever the empirical fact is, that the right answer is you focus not on the price absent the challenged conduct but on the competitive price, but I thought his basic answer was correct --

DR. WERDEN: Why?

MR. KRATTENMAKER: -- which is, you know, I do not know either better than the other.

DR. WERDEN: I don't want you to give an answer now. I want to know why.

MR. KRATTENMAKER: Because that is what we are more likely to be able to assess the supply and demand responses to, that --

MR. BISHOP: But doesn't --

MR. KRATTENMAKER: -- as the market definition process asks us to do.

MR. BISHOP: But this comes down to, I mean, there's practically no difference. I mean, if you knew

what the competitive price was in every single industry, antitrust policy would be extremely easy, just go around and tell firms that you are not allowed to price more than the competitive price.

MR. de la MANO: I wouldn't be so drastic on that, Simon. I think the question has merit. I do not know what the theoretical answer to this is, but I think from a practical standpoint, I actually think it could be easier in some cases to assess what the price would be in the absence of the conduct given that we are very unlikely to see, going back in time, a market which is currently not competitive that might have been competitive in the past, but it is very likely to see a situation that a few years ago, a market being a monopoly was one where that conduct was absent, and it might be possible to compare or even do some natural experiments across regions, even contemporaneously, to compare what is the precise situation where the conduct is absent. So, this theoretical conversation, were it to be valid, I think in practice, it could be very useful.

MR. BISHOP: Well, I still think that, you know, either benchmark means that the inferences that you can draw from, you know, the available data is similar to the same issues, whether it is a competitive price or a

price absent the conduct. Just seriously, from a practical point of view, I do not think it makes any difference at all. We can have a, you know, good, you know, theoretical debate in saying which one is the appropriate one, but from a practical point of view, I do not think there is any difference whatsoever.

DR. WERDEN: We have pretty much covered this one, but we are going to put it up anyway, see if anybody has anything more to add.

"A market-share based safe harbor is appropriate in monopoly cases."

MR. BISHOP: Yes.

DR. WERDEN: Okay, we have one yes.

MR. de la MANO: Two.

MR. SIMS: What's the number?

DR. WERDEN: That's the next slide.

MR. SIMS: I can't answer it without the number.

DR. WERDEN: Pick your own number.

MR. KRATTENMAKER: I say no to this sentence because it has a singular noun.

MR. SIMS: If you give me -- if you give me a, you know, 70 percent or an 80 percent number, I might be very comfortable with that.

DR. WERDEN: Okay, we have got a vote for 70 or 80 percent. We might not have unanimity on 70 or 80

percent.

DR. STELZER: What is it appropriate to? If it is appropriate as a general prosecutorial guide for guys picking cases to bring, along with the feasibility of relief, then it might be useful, but --

DR. WERDEN: If it is a safe harbor, it is a rule that courts are going to use on summary judgment to kick out cases.

DR. STELZER: Then I would say no.

MR. SIMS: And I know Tom says no. He has to say no.

MR. KRATTENMAKER: Yes, I did. I already said no. I would say yes, it might make sense to have one safe harbor --

DR. WERDEN: You're saying yes, but you're coming in with a low number, right, 25?

MR. de la MANO: I find it hard to understand this myth, which I alluded to before, that in Europe we have a serious concern with type II errors, yet when it comes to using market share safe harbors, there is consensus here on this side of the table that they can be used. Isn't that a sign that you want to leave open the possibility to bring any type of case, irrespective of market shares being rather low?

MR. SIMS: Well, no, that's not my reason at

least. My reason for being nervous about safe harbors unless they're very high is the concern that the safe harbor set too low will end up with serious over-enforcement above that number.

MR. BISHOP: Okay, but this comes back to the sort of philosophical or institutional, philosophical differences between the EU and the U.S., because personally, I would set the threshold at 70-80 percent, but I'd much prefer in the EU to have one of 40 percent than to have no threshold at all.

MR. SIMS: Okay, and that's a fair point given the regulatory environment that you find yourself in.

MR. WALES: I guess one question I had, Tom, is I thought I had read where you talked about the possibility of having different thresholds perhaps for different types of -- your two types of conduct. You had the conduct where someone acts to reduce output on their own as opposed to acting to exclude rivals, and I guess you kind of left open the proposition I thought that perhaps you might be willing to look for markets with the former and not the latter.

MR. KRATTENMAKER: No, I might be willing to look for one for each. That's why I said, my objection to this is that it -- that the noun is singular.

DR. WERDEN: Do you have some numbers in mind?

MR. KRATTENMAKER: Do I have numbers in mind? No, but I think you might well be able to come up with market share based safe harbor for exclusionary conduct section 2 cases.

MR. WALES: I have a question for --

MR. KRATTENMAKER: But it wouldn't, in my view, be an appropriate -- it wouldn't be the same threshold that would be appropriate for collusion-based section 2 type cases, which are generally rare but still can be out there.

MR. WALES: A quick question for Miguel, I guess where does 40 come from in terms of setting the threshold level in the European Commission?

MR. de la MANO: Well, as far as I know, it is from a case, but, I mean, I think the thing is -- I think the discussion is also highlighting this -- there is a question as to, you know, what is the threshold going to be used for? If you believe that once you are above the threshold, basically the case has been proven, then clearly you want to have as high a threshold as possible.

If, on the other hand, you believe as I do, at least, that the threshold is just the first step, just the screen to sort of ditch the cases which are obviously not a problem, if you have sufficient

discipline imposed upon yourself as a competition authority in what you need to prove further, there is no problem in having a low threshold. In fact, it is probably better to have a low threshold, because that makes the assessment of your facts credible.

Otherwise, if you have a threshold at a sort of middle level, such as 40 or 50 percent, there is always going to be a group of people who think, a-ha, okay, so this discipline you say you have, that you are going to go after -- assessing the effects afterwards, after showing dominance, it is not really true, because as soon as you are above 50, it is really easy to assess the facts, and therefore, there is no credibility to the second discipline, as it were.

MR. BISHOP: Okay, but I would take a different view, and sort of just to be clear here, when I said that dominance in Europe is then inferred to be an abuse of, you know, of that market power, that's not my position. That's the position of the European courts, that most of the issues we are talking about here are exclusionary, and the courts have held that any harm to a competitor necessarily leads to harm to competition, and therefore, given that sort of standard by the European courts, there is no room, really, for an effects-based system.

So, as you lower the threshold from 40 percent to 25 percent, it makes things much worse in Europe unless the Commission is going to be very clear that they are going to take on the courts and that court reasoning, that you can infer harm to competitors necessarily translates to harms to competition, that, you know, the Commission is going to take that square on, because if they do not, any lowering away from the 40 percent to just come out of case law is just going to make things worse.

MR. de la MANO: The court has already told us a few months ago that it is willing to reconsider its previous positions on this matter, and in the Glaxo decision -- and actually, it is actually an area of Article 81, cartels or agreements, but it has made it very clear that it is very open and willing to see a more effects-based analysis on the part of the Commission both in the area of assessing possible harm to consumers, but also in the area of assessing efficiencies. So, I think the courts are open to be challenged by the Commission on this point.

MR. BISHOP: Well, I would just say, you know, let's wait and see, stick with 40 percent and then see how they move before lowering the threshold.

MR. WALES: Let's go to the next one.

DR. WERDEN: Skip the next one and go one further.

MR. KRATTENMAKER: Can we mail in our answers to the one, number seven?

DR. WERDEN: If you like. It is about econometrics. Did you want to handle it, Tom?

MR. KRATTENMAKER: Of course. I mean, that's the most fun, is talking about something that we do not know. I thought it was a really interesting and provocative question. I think it is largely correct, but I would have some comments on it, but go ahead.

DR. WERDEN: We are nearing our end point.

MR. KRATTENMAKER: No, go ahead.

DR. WERDEN: As our end point, we are going to take this last proposition from the Syufy case, one of our failures in court.

"In evaluating monopoly power, it is not market share that counts, but the ability to maintain market share."

MR. KRATTENMAKER: Could there be anything more incorrect?

DR. WERDEN: I imagine that there could, but let me just add that I think what the quote is trying to say is the point that Joe made several times, which is durability is crucial in monopoly power.

MR. KRATTENMAKER: I see, okay.

DR. WERDEN: And monopoly power requires much more durable power over price than market power does.

MR. KRATTENMAKER: Gotcha.

MR. SIMS: When I read this, my answer was, I do not know exactly what these words mean --

MR. KRATTENMAKER: Okay.

MR. SIMS: -- but if they mean durable market power, then --

MR. KRATTENMAKER: If they mean entry barriers and -- okay, you are saying they're importing it, okay.

DR. STELZER: As a practical problem with that, it is an easy matter in any case to find someone who will tell you why whatever monopoly power or market power you see is not durable. I have had people tell me that monopoly power in the transmission of electricity is not durable because they have some innovation in mind.

In other words, you can fill the courtroom with experts who will tell you why market power that has persisted for 150 years is really not durable given some new technology or given some new something, but --

DR. WERDEN: But they're wrong, aren't they? But you are saying that they're wrong?

DR. STELZER: They're wrong.

DR. WERDEN: Okay.

DR. STELZER: So I would be very careful about introducing a test that says not only do you have to have market power, but it has to be proved to be durable in order to create a problem, because that's an impossible test to meet.

MR. SIMS: It is true, and I think everybody should admit that it is true, that the more you get away from slogans and general rhetorical concepts and the closer you get to careful analysis of the facts, the less enforcement you are going to have, because it is harder. It is harder for plaintiffs, whether they're the Government or private plaintiffs, to prove a case if they have to slog their way through the facts.

That's why the per se rule is so attractive to plaintiffs' lawyers in damage cases, because they do not have to prove anything. So, you know, that's an inevitable result of being more wedded to factual analysis than setting up bright-line rules. I don't think it is a reason not to do it, but it is a result that we ought to be -- that we ought to recognize and accept.

MR. WALES: Anybody else?

DR. WERDEN: Well, we are a few minutes past our official end time, so why don't we wrap it up and take

one last opportunity to thank our panelists.

(Applause.)

MR. WALES: Thank you very much. I guess we are adjourned.

(Whereupon, at 4:34 p.m., the hearing was adjourned.)

C E R T I F I C A T I O N O F R E P O R T E R

DOCKET/FILE NUMBER: P062106

CASE TITLE: SECTION 2 HEARING

DATE: MARCH 7, 2007

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by me at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED: 3/12/2007

SUSANNE BERGLING, RMR-CLR

C E R T I F I C A T I O N O F P R O O F R E A D E R

I HEREBY CERTIFY that I proofread the transcript for accuracy in spelling, hyphenation, punctuation and format.

DIANE QUADE