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SHIMMERS IN THE PENUMBRA OF SECTION 5 AND OTHER NEWS

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Mary L. Azcuenaga, Commissioner
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Good morning. It is a great pleasure to be here in Santa Fe and to talk with you again about competition law and policy from my perspective at the Federal Trade Commission. As you know, the views I express are my own and do not necessarily represent the views of the Commission or any other Commissioner.

I plan to skip around today and talk about three areas that are of interest to me that also happen to be areas of current government activity. I will start with a few general observations about the flexibility and constraints of antitrust analysis as applied in dynamic, high tech industries. Second, I will make a few observations about the new merger guidelines, and third, I would like to venture into the penumbra of Section 5 of the FTC Act. In an effort to weave these disparate subjects into a single cohesive topic, which is not easily done, I might call my theme for the day: ventures into the antitrust unknown.

One thing that keeps antitrust such an interesting area of the law is that we are continually required to analyze new industries. In that sense, we must attempt to master the unknown in many of our cases. Some new, high technology industries, especially those in which innovations and new generations of products occur frequently, present a special challenge.

As in other antitrust contexts, scholars hold strongly divergent views about how antitrust rules should apply to high

tech industries. Although I am not a student of the work in this area, I understand that Michael Porter argues for a strong antitrust regime to promote intense domestic rivalry in order to foster innovation.[1] To this end, he would circumscribe cooperative research, prohibit joint production and marketing between leading rivals, block mergers of leading firms, and generally promote deconcentration of economic power.

Others, such as Jorde and Teece, argue that the process of innovation requires an array of linkages and feedback mechanisms. They believe that efficiencies afforded by the horizontal or vertical linkages of joint ventures promote innovation, and they argue that overly strict antitrust enforcement can hamper the process of innovation.[2]

Alliances or specific joint ventures may help high tech firms lead or keep up with succeeding steps in innovation. Agreements among firms may be made for a wide variety of procompetitive reasons, and antitrust enforcement authorities should be careful about condemning such agreements for fear of chilling the joint efforts that may be necessary to encourage or facilitate innovation.

The pace of change in certain high tech industries puts our mode of analyzing competitive effects to the test. Much conventional antitrust analysis is static. To borrow a word from

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[1] M. Porter, The Competitive Advantage of Nations (1990).

[2] Jorde and Teece, "Acceptable Cooperation Among Competitors in the Face of Growing International Cooperation," 58 Antitrust L.J. 529 (1989).

the economists, we need to consider how "robust" the conclusions of static analysis are, as applied to dynamic markets. An industry characterized by rapid and significant shifts in market leadership and other market conditions as a result of inventions or scientific breakthroughs may require a more dynamic analysis.

Because there are some inherent difficulties in obtaining a clear understanding of the competitive implications of conduct in dynamic, innovation-driven industries, I think that the Commission should be very careful in investigating and prosecuting companies in these industries to ensure that our activities do not discourage the innovative activity we seek to promote. This does not mean that high tech should translate into special preferences under the antitrust laws. High tech firms should be held to the principles of fair competition, but it is appropriate, in reviewing their conduct, for the government to maintain a healthy respect for their visionaries and their competitive successes. Many aspects of these industries seem to be generally competitive, and perhaps we should keep in mind the admonition, "If it ain't broke, don't fix it." The Commission is aware of the important dynamic considerations of competition in high tech industries, and we are attempting to account for them in our analysis.

In addition to analyzing new industries, another thing that keeps life interesting for government antitrust enforcers is the occasional opportunity to develop and try out new methods of analyzing familiar problems. The 1992 Merger Guidelines reflect

the joint effort of the FTC and the Department of Justice to articulate how our analytic techniques have evolved in recent years. The Guidelines provide a fertile field for discussion, but I will confine myself to a few observations on the treatment of competitive effects.

One of the less familiar sections of the new guidelines for many antitrust practitioners is the discussion of unilateral competitive effects. The concerns about unilateral effects arise from two possibilities, and both build on the dominant firm aspect of the 1984 Guidelines. A unilateral competitive effect relates to the ability of a merged firm profitably to raise prices above the pre-merger price without the need to coordinate with other firms in the market.

In the new guidelines, unilateral anticompetitive effects occur when competition among firms producing differentiated products is reduced as a result of a merger. Alternatively, unilateral effects may arise when products are undifferentiated and capacity shapes competition among firms in a market. Since these two possibilities cover different fact situations, they will require different evidence and perhaps different investigational approaches.

The unilateral effect involving differentiated products recognizes that the products of some firms are closer substitutes for one another than are the products of other rivals. If two particularly close rivals merge, and they possess a substantial market share (35 percent or more in the guidelines), the merged

firm may be able to raise price for a significant group of consumers. When the two products of the merged firms are the first and the next best choices for a significant group of consumers, the price increase is assumed likely to succeed, because those consumers that do shift will choose the next best substitute. Simply put, a firm controlling both such products is likely to charge higher prices for them than if the products are supplied by separate firms.

To assess the potential for this effect, we would need information about the products sold by the firms in the market and a reasonable assessment of their substitutability. Basically, we will need to discern the attributes consumers desire in a product and the extent to which the products of the merging firms are the first and second choices of a significant group of consumers. In analyzing whether the products of the two firms in question appear to be the closest competitors to one another, important information may be found in the studies and other internal documents of the merging parties, such as customer call reports.

Assuming we find that the two merging parties sell the most closely related products, we also would consider whether rivals can reposition their products quickly and without significant sunk costs. Documents might show such repositioning in the past, and firms in the industry may provide information about the difficulty of repositioning products in response to a price increase.

Finally, it is necessary to consider whether a price increase for one or both products would be profitable. This may be most easily determined if prices are set for each customer or customer class. For example, in a bidding situation, the merging parties may be able to enter higher bids for those customers who do not have other good choices. Here we would search for information on how sensitive different buyers are to price increases of the products of the merged firms.

The second unilateral theory, based on capacity, seems in some ways less complex. Here the assumption is that firms produce relatively homogeneous products but competitors of the merging firms face a significant constraint on their capacities. When a relatively large firm (the guidelines posit a combined share of at least 35 percent) results from a merger, it may be able to raise prices after the merger, when other firms cannot expand their output in response to the price increase. The profitability of the increase in price will depend on the combined share of the merged firm, its cost structure, the elasticity of demand, whether non-merging firms have excess capacity, and the cost of using this capacity for production.

Assessing the potential for this unilateral effect would involve an analysis of capacity data from the merging parties and other firms in the market, qualitative and historic information about product homogeneity, and information about the ability of third parties to expand production quickly. It is particularly important to identify any capacity constraints and the cost of

bringing excess capacity into production. This theory will be particularly worth investigating when the shares of the merging parties are large, the quantity of product the remaining firms are able to supply is relatively insensitive to price changes, and the demand is also insensitive to price changes.

Overall, the new Guidelines add structure to the competitive effects analysis, which may help focus investigations on the relevant anticompetitive theory. I hope that this will enable us to narrow the scope of the investigation at an early stage and have the potential to simplify information gathering. On the other hand, the kinds of information that will be needed and the basic analysis are not fundamentally different from what we have been doing, so the degree of change may not be significant.

Although the 1992 Guidelines also have a new treatment of the collusion story or "coordinated interaction" in merger analysis, this section may seem quite familiar to the experienced practitioner. In most merger investigations, our effort to estimate potential competitive effects has focused on the possibility that the merger will increase the likelihood of collusion. In Hospital Corporation of America[3], the Commission's approach was similar to that of the new guidelines, discussing the likelihood of and potential obstacles to

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[3] 106 F.T.C. 361 (1985), aff'd, 807 F.2d 1381 (7th Cir. 1986), cert. denied, 481 U.S. 1038 (1987).

collusion. Also, in B.F. Goodrich,[4] the Commission discussed at length the ability of firms in the market to determine and enforce a collusive price. The 1992 Guidelines provide an extended description of the analysis, but it is not a fundamental change in approach.

Now I would like to turn to what I call the penumbra of Section 5 of the FTC Act. Section 5, of course, is the basic statute by which the Commission is empowered to regulate "unfair methods of competition." By the penumbra of Section 5, I mean those unfair methods of competition that do not constitute violations of the Sherman Act or the Clayton Act but nevertheless pose a sufficient threat to competition that they violate the FTC Act. What kind of a sufficient threat to competition might that be? Two major developments at the FTC in the last two months are important steps in answering this question. Before turning to them, it may be interesting and possibly even useful to start with a brief historical perspective on the penumbra of Section 5.

Traditionally, in analyzing conduct under Section 5 of the FTC Act, the Commission has employed theories and precedents that have developed under, or are analogous to those developed under, the Sherman and Clayton Acts. Yet, it seems clear that the Commission's authority under Section 5 is broader than either the Sherman Act or the Clayton Act. In the past decade, the Commission made little use of Section 5 to challenge

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[4] 110 F.T.C. 207 (1988), appeal dismissed by stipulation, Nos. 86-4065, 86-4066 (2d Cir. April 24, 1989), modified final order, 112 F.T.C. 83 (1989).

anticompetitive conduct that does not rise to the level of a violation of another statute, such as unilateral conduct that does not violate Section 2 of the Sherman Act. Use of this extra range of the Commission's authority under Section 5 is somewhat less traditional, but, at the same time, not entirely unfamiliar to the antitrust practitioner.

In the 1940's, the Commission employed a pure Section 5 theory as part of a broad attack on base point pricing that met with some initial success before the effort was abandoned in 1949. The high water mark of this effort came when the Seventh Circuit decided that the use by one firm of a base point pricing system with knowledge that other sellers use it constitutes an unfair method of competition. Triangle Conduit & Cable Co. v. FTC, 168 F.2d 175, 181 (7th Cir. 1948), aff'd by an equally divided Court sub nom. Clayton Mark & Co. v. FTC, 336 U.S. 956 (1949). The Commission issued a two count complaint, alleging a traditional conspiracy theory and an alternative unilateral conduct theory and found liability on both theories.[5]

In support of its decision that the unilateral adoption of the pricing formula violated Section 5, the Commission argued to the Court of Appeals that unfair methods of competition encompass "not only methods that involve deception, bad faith, and fraud, but methods that involve oppression or such as are against public policy because of their dangerous tendency unduly to hinder

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[5] Rigid Steel Conduit Association, 38 F.T.C. 534 (1944).

competition or create monopoly." 168 F.2d at 181. The Seventh Circuit affirmed, stating that the "individual use of the basing point method as here used does constitute an unfair method of competition." Id.

The Seventh Circuit decision came only two months after a Supreme Court opinion that seemed to anticipate the result. In FTC v. Cement Institute, 333 U.S. 683 (1948), the Court upheld the Commission's finding that cement producers conspired in adopting a multiple base point pricing formula. Although the case was based on a conspiracy theory, the Court observed in a footnote that proof of the "combination" element might not be an indispensable element of an unfair method of competition under Section 5. 333 U.S. at 721 n.19.

After Triangle Conduit, the Commission in a press release announced that the individual adoption of base point pricing may be an unfair method of competition even absent a combination or conspiracy. Interim Report on Study of Federal Trade Commission Pricing Policies, S. Doc. No. 27, 81st Cong., 1st Sess. 41 (1949). The Commission's lead attorney in these cases appeared on a national radio broadcast to state that he favored mandatory f.o.b. mill pricing. Id. at 48.

As a result of the decisions and the ensuing publicity, legislation to change the result was proposed. In the Senate Committee hearings, commissioners were subject to questioning that I would characterize as demanding. Ultimately, the Congress discontinued its consideration of the legislation after a

majority of the commissioners recanted and testified that Section 5 prohibits only conspiracies to adopt base point pricing. Id. at 58-63. The Senate Committee Report observed, apparently with some understatement, that the Commission modified its position in response to broad opposition. Id. at 59. The transcripts of the hearings and the committee report provide some painfully entertaining reading. For the commissioners involved, the experience no doubt provided indelible memories of the delights of public service.

Despite the abandonment of the base point pricing effort, the Commission, in the 1960's, successfully litigated cases that extended the reach of Section 5 beyond the limits of the Sherman and Clayton Acts. The Supreme Court affirmed the Commission's authority to "arrest trade restraints in their incipiency" without proof of a Clayton Act violation[6] and affirmed an order against conduct that was analogous to tying but did not amount to a tying violation.[7] In 1972, the Supreme Court adopted an extremely expansive view of the Commission's authority, saying that Section 5 empowers the Commission "to define and proscribe an unfair competitive practice, even though the practice does not infringe either the letter or the spirit of the antitrust laws." That case, of course, was FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 239 (1972).

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[6] FTC V. Brown Shoe Co., 384 U.S. 316, 322 (1966).

[7] Atlantic Refining Co. v. FTC, 381 U.S. 357, 369 (1965).

Emboldened by Sperry & Hutchinson, the Commission undertook an even more expansive effort to extend the reach of Section 5 that ended in a series of failures. The major shared monopolization cases did not even reach the stage of a final Commission decision on the merits. The oil industry case was dismissed without prejudice after eight years of inconclusive pretrial discovery,[8] and the Commission dismissed the cereal case with prejudice, after vacating the Initial Decision adverse to Complaint Counsel.[9] The Commission also lost two important facilitating practices cases, Du Pont and Boise Cascade, in the Courts of Appeals.[10]

They say that experience is what enables you to recognize a mistake when you make it again. But it is my hope that the Commission's historical lack of success with expansive readings of Section 5 in competition cases will enable us to take sufficient precautions to avoid past mistakes. Du Pont and Boise Cascade are the leading cases, and overcoming those precedents is a daunting proposition. In my view, the Commission should employ an expansive reading of Section 5 only if we can articulate a compelling theory of competitive harm and prove it with clear evidence. It is unlikely that an expansive interpretation of

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[8] Exxon Corp., 98 F.T.C. 453 (1981).

[9] Kellogg Co., 99 F.T.C. 8, 269 (1982).

[10] E.I. Du Pont de Nemours & Co. v. FTC, 729 F.2d 128 (2d Cir. 1984); Boise Cascade Corp. v. FTC, 637 F.2d 573 (9th Cir. 1980).

Section 5 can achieve credibility until the Commission has successfully defended the position on appeal.

There are skeptics who view the expansive scope of Section 5 as a threat and who think that the Commission, as a matter of policy, should refrain from exploring the outer limits of Section 5. These are the people who, along with P.J. O'Rourke, believe that "giving money and power to government is like giving whiskey and car keys to teenage boys."[11] No doubt there are others who believe that, to protect the public, the Commission should stretch Section 5 to its limits in the hope of curing any and every perceived disfunction in the economy. My perspective is somewhat more trusting than the former and more modest than the latter. I think that the broader coverage of Section 5 is a good thing to have, but that the Commission should exercise it with care so that it does not turn into a monster.

Section 5 can be put to good use filling gaps or loopholes in the antitrust laws. In merger cases, for example, the Commission has charged both the acquiring and acquired firm with violating Section 5, although the specific Section 7 prohibition against anticompetitive mergers runs literally against the acquiring firm only.[12] Without attempting to reconstruct the theory why Section 5 of the FTC Act provides an appropriate basis to charge the acquired firm, I will simply observe that the

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[11] P.J. O'Rourke, Parliament of Whores at xviii (1991).

[12] Dean Foods Co., 70 F.T.C. 1146, 1288-92 (1966)(finding that the acquired firm violated Section 5 by signing the purchase contract).

Commission has successfully followed that practice for twenty-five years and that the practice has been useful.

A more newsworthy event, indeed, an event that caused the penumbra of Section 5 to shimmer, is the recent consent agreement accepted for public comment involving The Vons Companies. Here again Section 5 was used to fill a gap in the coverage of Section 7. It is perhaps somewhat ironic that a major development in the application of Section 5 should arise in a case of this name, but I feel confident that this Vons will earn a better reputation than the earlier Vons, whether rightly or wrongly, has come to have.

In this Vons, the relevant product market was supermarkets, and the relevant geographic market was the area in and around the city of San Luis Obispo, California. The complaint alleged that concentration in the market was high and entry difficult. Three competitors operated all the supermarkets in town. Vons owned a single supermarket, Williams Bros. owned three, and there was a third competitor.

According to the complaint, in September of 1991, after discussing with Williams Bros. the terms of a transaction to buy all three of the Williams Bros. stores in San Luis Obispo, Vons sold its only supermarket in San Luis Obispo to a drugstore operator at a price below what another grocer was willing to offer. This sale, at an unnecessarily low price, combined with the vision of future acquisitions dancing in Vons' head, suggests a motive to remove supermarket capacity from the market. The

sale also caused the number of supermarket operators in San Luis Obispo to decline from three to two. In December 1991, Vons formally entered into an agreement to purchase the three Williams Bros. stores. The number of supermarket operators did not change as a result of the subsequent acquisition alone, because by then Vons was no longer in the market, and it simply displaced Williams Bros. There were two competitors immediately before and immediately after the acquisition.

Although the Commission challenged Vons' acquisition of the three stores from Williams Bros., it had to deal somehow with the situation that Vons' prior divestiture of its single store had eliminated the competitive overlap that usually provides a basis for a Section 7 case. The Commission alleged a violation of Section 5 on the theory that Vons had deliberately and effectively secured market power by eliminating capacity in the market and buying out a competitor. The Commission alleged a violation of Section 7 on the theory that Vons' sale of its single supermarket was "inextricably intertwined" with its subsequent acquisition of three supermarkets.[13]

I voted for the consent order on the basis of Section 5 and issued a separate statement saying that I did not reach the question whether Section 7 also prohibited the acquisition of the three stores. Regardless of whether Section 7 would bar the transaction, the anticompetitive potential of the sequential

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[13] Complaint ¶ 10, The Vons Companies, Inc., 57 Fed. Reg. 23,410 (June 3, 1992).

transactions seems clear. The Vons consent seems to me an excellent example of a good and proper use of the penumbra of Section 5.

Other uses of Section 5 to condemn business practices that do not involve a combination or conspiracy and do not present problems of monopolization may be more controversial. The effort to prohibit facilitating practices is the most recent effort to condemn such conduct. The leading case on facilitating practices is, of course, Ethyl Corp., 101 F.T.C. 425 (1983), vacated sub nom. E.I. Du Pont de Nemours & Co. v. F.T.C., 729 F.2d 128 (2d Cir. 1984). The Commission entered an order prohibiting all four producers of lead antiknock additives for gasoline from using uniform delivered pricing. It also prohibited the two largest producers from giving advance notice of price increases and giving "most favored nation" contract clauses. The Commission's legal theory was that these "facilitating practices" violated Section 5 of the FTC Act. 101 F.T.C. at 652. Of course, an explicit agreement among competitors to adopt a uniform approach to competition has long been unlawful, but here no explicit agreement was alleged.

The Commission found "extremely high concentration, high barriers to entry, a homogeneous product, inelastic demand," and other factors conducive to collusion. 101 F.T.C. at 651. Second, it found high profits consistent with prices in excess of marginal cost, stable market shares, rising prices in the face of stable demand, excess capacity, limited discounting, lock-step

price increases, and highly uniform prices. Id. Third, the majority found that the facilitating practices had the effect of significantly reducing price competition. Id.[14]

Vacating the Commission order, the Second Circuit said that although the Commission has the authority to find noncollusive, nonpredatory and independent conduct to be a violation of Section 5, the court would apply closer scrutiny upon judicial review as the Commission moved "away from attacking conduct that is either a violation of the antitrust laws or collusive, coercive, predatory, restrictive or deceitful...." E.I. Du Pont de Nemours & Co. v. F.T.C., 729 F.2d 128, 137 (2d Cir. 1984). The court emphasized the need for clear standards to distinguish between unreasonable conduct and lawful business practices. Absent collusion, the court required "some indicia of oppressiveness . . . such as (1) evidence of anticompetitive intent or purpose on the part of the producer charged, or (2) the absence of an independent legitimate business reason for its conduct." Id. at 139 (footnote omitted). The court concluded that the record did not have substantial evidence showing "a causal connection between the challenged practices and market prices." 729 F.2d at 141.

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[14] Former Chairman Miller dissented, but said "I do not necessarily reject the general concept underlying the new cause of action created by the majority." 101 F.T.C. at 656. Despite that statement, Miller expressed skepticism about its theoretical bases and practical utility. Miller argued that the majority's standard for the violation was anticompetitive, vague and unpredictable, and, just for good measure, that the majority had misapplied it in any event. Id. at 657.

The Court of Appeals found that independent business reasons justified the conduct in question in Du Pont. I will not recite the evidence in the case, but generally it seems fair to say that the court seemed willing to find legitimate business reasons on the basis of relatively slim evidence. Some of the business justifications may have been valid when the practices were first adopted during the time when Ethyl was the sole producer, but the court seemed highly deferential to business purposes by continuing to accept the justifications decades later when circumstances had changed.

The Commission recently accepted settlements with two infant formula producers and issued a complaint against a third that raise many of the same issues posed by Du Pont. These actions were a major event. It is the first time since Du Pont in which the Commission has relied solely on a pure Section 5 theory. Also, in financial and human terms, the case was important. Mead Johnson & Company and American Home Products signed settlements filed in district court in which each agreed to an order against certain unilateral conduct and made restitution for alleged overcharges for infant formula sold through the government sponsored Special Supplemental Food Program for Women, Infants and Children ("WIC program"). Abbott Laboratories did not sign a settlement, and the Commission filed both a district court complaint and an administrative complaint against Abbott.

The complaint against Mead Johnson alleged three separate counts based on Section 5. All three counts involve allegations

of unilateral conduct, but the alleged conduct and the theories on which each count is based are quite different. The first theory involved a very specialized sort of price signalling. In the WIC programs, which are administered on a state-by-state basis, but are funded by the federal government, states require the submission of sealed bids for the contract to supply infant formula. In a letter of March 6, 1990, to four states, Mead disclosed the precise amount it planned to bid in the upcoming rounds of sealed bidding. The complaint alleged that Mead knew that its competitors would learn of its bid information in the letter and that the competitors in fact promptly did so.

The Commission found reason to believe that Mead's advance disclosure of its bids violated Section 5. Although I voted against the Mead complaint and settlement for other reasons, I supported this count because the evidence seemed sufficient to meet the various tests set forth by the Second Circuit in Du Pont. Mead allegedly intended to inform and influence its competitors in the sealed bid process, and no plausible business reason for the unsolicited letters was advanced. In addition, there was evidence permitting an inference of a causal connection between the conduct and anticompetitive effects. In the unusual circumstances of this case, an inference could be drawn, particularly in the sealed bid context, that the conduct involved both anticompetitive intent and anticompetitive effects.

The allegations and the count based on the letter of March 6 are much more limited than the allegation in Ethyl that the

companies provided extra advance notice of price changes, and I think that it would be a mistake to equate this settlement with a broad attack on advance notice of price changes. The WIC sealed bid format foreclosed business justifications that might be present in other markets and other contexts. In some situations, such as the Second Circuit found in Du Pont, advance notice of price changes might be demanded by customers and provided for their benefit. Other persons, such as shareholders and financial analysts, may have business interests in a company's pricing policies that could justify certain kinds of disclosures. I will not attempt to catalogue the other possibilities.

The second unilateral theory of the cases against Mead and American Home Products is a spin off from bid rigging. The complaints against Mead Johnson and American Home Products alleged that in a round of sealed WIC bidding in Puerto Rico, they "provided information" indicating that they preferred and would bid to support an open system in which all companies supplied formula, and, as a result, "uncertainty" relating to the bids was reduced. Each of the complaints against the two companies that settled was based on "theories involving non-collusive facilitating practices."[15]

In contrast, the complaint against Abbott alleged both a conspiracy "to fix, stabilize, or otherwise manipulate" the bids

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[15] Complaint ¶ 16, FTC v. Mead Johnson & Co., Civil Action No. 92-1366 (D.D.C. June 11, 1992); Complaint ¶ 12, FTC v. American Home Products Corp., Civil Action No. 92-1365 (D.D.C. June 11, 1992).

and the count based on unilateral conduct. I voted in favor of issuing the complaint against Abbott based on the conspiracy count alone and voted against the complaints against the other two firms. If they engaged in the conduct alleged without conspiring with each other, I found it difficult to understand where the violation lay. I would have voted in favor of a complaint that contained a bid rigging count against the two firms that settled, because I had reason to believe that they in fact had conspired.[16]

In these cases, the allegations of "non-collusive facilitating practices" can perhaps best be understood in the context of a settlement. The Commission obtained full restitution for the overcharges from the two settling firms, and for their part, the two companies that settled avoided whatever stigma might be associated with a charge of bid rigging. Keep in mind that the Commission found reason to believe that Abbott engaged in a conspiracy involving the same factual situation for which the Commission charged Mead and American Home Products only with unlawful unilateral conduct. What significance, if any, this point may have on future policy regarding unilateral conduct is unknown. I would worry if I thought that we were using the penumbra of Section 5 to allege unlawful unilateral conduct simply as a fallback when we question the strength of our

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[16] Statement of Mary L. Azcuenaga Re: Infant Formula Manufacturers (June 11, 1992).

evidence to establish a conspiracy. But I assume that is not the use the Commission intends.

The Mead settlement included a third theory based on an advertising restraint. That conduct is the subject of an administrative complaint involving Abbott. Again, I dissented on the unilateral count, but supported the conspiracy count. I will refrain from talking about the third unilateral theory pending the outcome of the litigation.

The infant formula case is not the only matter in which a unilateral Section 5 theory is being considered. Several matters are now being studied in which the theory that a solicitation to collude violates Section 5 is being advanced. These cases involve a communication by one competitor to another that can be construed as an invitation to fix prices, but not a completed agreement. At least some of the cases do not involve market concentration in the range of a monopolization case.

The leading case involving a solicitation to fix prices was brought under a Sherman Act, Section 2, attempt to monopolize theory. In United States v. American Airlines, Inc., 743 F.2d 1114 (5th Cir. 1984), Robert Crandall, the president of American, telephoned Howard Putnam, the president of Braniff, and explicitly, and in somewhat colorful language, offered to raise American's fares by twenty percent if Braniff did so first. Crandall said: "You'll make more money and I will too." Id. at 1116. Instead of raising his prices, Mr. Putnam gave a tape of the conversation to the Justice Department. (And whoever said

competition was pretty?) At the time, Braniff and American together had a near monopoly on certain air routes, and entry was not easy because of FAA limitations on arrivals imposed after the air controllers' strike.

The Fifth Circuit held that Crandall's statement, if proved, was an attempt to monopolize. The court employed the traditional test for attempted monopolization: "(1) specific intent to accomplish the illegal result; and (2) a dangerous probability that the attempt to monopolize will be successful." 743 F.2d at 1118. The first element, specific intent, was fairly clear from Mr. Crandall's "uniquely unequivocal" invitation. Id. at 1119. In finding the requisite dangerous probability, the Court of Appeals emphasized three facts: first, Crandall and Putnam were chief executive officers and had the power to change price; second, the two airlines had a high share of a market with high barriers to entry; and third, if Putnam had agreed, the two companies would immediately have monopolized the market. Id. at 1118-19.

Although the Fifth Circuit observed that the Sherman Act does not prohibit unfair, impolite, or unethical acts, 743 F.2d at 1119, the argument for extending the reach of American Airlines via Section 5 of the FTC Act is fairly apparent. Since Section 5 reaches unfair methods of competition, a solicitation to collude might violate Section 5 even in the absence of joint monopoly power.

Proponents of the theory might argue that solicitations to collude have no social or business value, so why not prohibit them? The history of the Commission's past attempts to extend the reach of Section 5, however, suggests that the statute is not a carte blanche to condemn whatever conduct the FTC regards as socially undesirable. This was the warning sounded by the Second Circuit in Du Pont: the application of Section 5 must distinguish between normally acceptable business behavior and unreasonable conduct; "[o]therwise the door would be open to arbitrary or capricious administration of § 5...." 729 F.2d at 138.

Another suggestion advanced in favor of declaring solicitations to collude a violation of Section 5 is that it may deter actual price fixing by making businessmen less willing to propose an agreement. I agree that price fixing is a serious offense, and I suppose that some deterrent effect at the margin is possible from prohibiting unsuccessful attempts to fix prices. But price fixing already is subject to criminal prosecution, and it also exposes a firm to treble damages liability. A member of the business community, who is willing to take those kinds of risks, might not find any additional deterrence in the prospect of an FTC order to cease and desist.

The Justice Department's criminal prosecutions of attempts to rig bids under a wire fraud statute have been cited to justify an expanded use of Section 5. E.g., United States v. Ames Sintering Co., 927 F.2d 232 (6th Cir. 1990). I am not sure where

this takes us. The fact that certain conduct meets the specific elements of a wire fraud statute may not tell us much about the meaning of Section 5. Section 5 condemns "unfair methods of competition," a term that historically has been defined by reference to the Sherman and Clayton Acts, not criminal laws that are not designed to preserve competition. I can easily imagine a criminal statute that, like some civil statutes, sounds in competition but in fact provides special protection from the rigors of competition to individual firms. Surely, we would not want to incorporate that concept as a basis for liability under Section 5.

In considering an expanded Section 5 prohibition against invitations to collude, it may be useful to identify whether the market structure is conducive to collusion and to define the extent of the solicitation. One reason for per se treatment of actual agreements to fix prices is the assumption that the price fixers have some reason for believing that their agreement will work.[17] The fact of an agreement suggests that at least two firms have resolved whatever problems of detection and punishment of cheating may accompany formation of a cartel, even though proof of these ancillary matters is not necessary to proof of an unlawful agreement. In a solicitation case it is probably fair

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[17] Clarity and ease of enforcement have been cited in support of the per se rule against price fixing, as well as the circumstance that "[v]ery few firms that lack power to affect market prices will be sufficiently foolish to enter into conspiracies to fix prices." R. Bork, The Antitrust Paradox 269 (1978).

to assume that the person making the solicitation believes that it could succeed. The person who rejects the offer, however, may do so for a variety of reasons, such as a desire to obey the law or a belief that collusion would fail in that industry or among a limited group of competitors. In the latter event, the basis for a per se inference would be weakened.

Another relevant fact is who is doing the talking. In American Airlines, the Fifth Circuit noted that the two participants in the phone conversation were both CEO's who had immediate authority over price. Less senior employees might also attempt to conspire, but one needs to ask whether the individuals in question speak with the authority of the corporation.

The circumstances surrounding an alleged invitation also might be important. A private communication, such as Mr. Crandall's call to Mr. Putnam, can produce a secret conspiracy. A public statement resulting in an unlawful agreement would be easier to detect. The potential for harm to competition is not diminished by the circumstance that an unlawful agreement is reached in public, but the ease of detection may reduce the probability of success. What is the difference, in terms of effects on competition, among a statement like that in American Airlines, an announcement in a speech that a firm intends to increase prices, and price announcements published in trade journals? As usual, the question is where to draw the lines.

The Commission's "facilitating practices" theories in the infant formula settlements and the pending matters involving

solicitations to collude have the common thread that one competitor allegedly attempts to reduce competition by communicating with another competitor or competitors. That conduct falls considerably short of a combination or conspiracy or monopolization. A possible anticompetitive effect seems to derive from a reduction in the competitors' uncertainty about the communicator's intentions.

Mr. Crandall's offer to Braniff was a recorded, explicit, unequivocal and unambiguous offer of an unlawful agreement. It may be a long time, however, before we run across another set of facts and proof as clear as that. In other cases, problems may arise in dealing with statements that might be construed as an offer relating to price, but that are not as clear as Mr. Crandall's. In cases of actual price fixing, proof of formal words of agreement is unnecessary to establish the offense,[18] and an agreement can be deduced from ambiguous statements and circumstantial evidence. Circumstantial evidence, for example, might relate to price movements, which could support an inference about the real meaning of an ambiguous statement. In pure solicitation cases, evidence may be less available to give content and context to an otherwise ambiguous message, and a real question arises about how willing we should be to ascribe an anticompetitive meaning to a statement.

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[18] Isaksen v. Vermont Castings, Inc., 825 F.2d 1158, 1164 (7th Cir. 1987), cert. denied, 486 U.S. 1005 (1988)(involving the agreement element of resale price maintenance).

A reduction in uncertainty is not necessarily unlawful. As the court observed in Du Pont, the competitors in that market learned of each other's price moves within hours, regardless of the challenged practices. 729 F.2d at 142. Mr. Crandall could lawfully have reduced Braniff's uncertainty by unilaterally raising American's prices, but he went the additional step and offered a specific agreement. Any effort to deter offers of an unlawful agreement should set some standards for what will be considered unlawful. A limitless ban on communication between competitors could chill lawful and even procompetitive communications, such as invitations to form a joint venture or unilateral announcements of useful price or market information.

Although Section 5 of the FTC Act does provide a useful protection against anticompetitive conduct in cases such as Vons, which rest on a solid theory of anticompetitive effect, in expanding the scope of Section 5, caution is in order before venturing too far into the unknown. The history of our past efforts to loosen the confines of traditional antitrust principles should help us to develop a sound anticompetitive rationale for any new theory and to articulate the evidentiary basis for concluding that it applies in a particular case. I am confident that the Commission is up to the task.