

## Reflections on the DG Competition Discussion Paper on the Application of Article 82 to Exclusionary Abuses

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I've had the luxury of being able to really study the DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses.<sup>2</sup> I say "luxury" because, quite frankly, I didn't have the time to thoroughly analyze papers of this kind when I was in private practice. Client--and court--demands more than filled my plate. I realize now what I missed.

I came away from my study of the paper with three overall impressions. First, I was surprised about the extent to which trans-Atlantic convergence has occurred on the basic theoretical principle underlying analysis of single-firm (or unilateral) conduct (e.g., recognizing consumer welfare promotion as the goal). There are, of course, still some differences in the analysis itself. For example, there is complete divergence in the paper's treatment of unilateral refusals to deal with rivals where our respective high courts have reached different conclusions about that. The market share threshold for "dominance" in the paper is also significantly lower than the threshold that exists for the monopolization offense (though not the attempted monopolization offense) in the U.S.

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<sup>1</sup> The views expressed herein are my own and do not necessarily reflect the views of the Federal Trade Commission or of any other individual Commissioner.

<sup>2</sup> European Commission, DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses, <<http://europa.eu.int/comm/competition/antitrust/others/discpaper2005.pdf>> [hereinafter DG Competition paper].

There is also one fundamental difference between the analytical model posited in the DG Competition paper respecting the efficiency defense on the one hand, and case law in the U.S. governing single firm conduct by a monopolist on the other. In the U.S., our Supreme Court said in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 605 (1985) that unlawful monopolization requires proof of an “attempt to exclude rivals on some basis other than efficiency.” In contrast, paragraph 91 of the Discussion Paper states that “[u]ltimately the protection of rivalry and the competitive process is given priority over possible pro-competitive efficiency gains.” Read literally, this would mean that, however efficient, conduct by a dominant firm that excludes a rival is illegal. Whatever one thinks of the law, this seems questionable in terms of policy. It would not let the most efficient rival win, which is contrary to the teaching in most of the rest of the Paper.

However, while there are differences, a sizeable amount of the discussion in the paper tracks what I read in the advance sheets reporting on judicial decisions in the United States. Not only that; some of the issues left open by the paper are the same ones that are not fully resolved by the United States Supreme Court. Clearly we are grappling with the same difficult issues on both sides of the Atlantic. More on that later.

Second, I was surprised about the extent to which convergence has occurred in the vocabulary noted in analysis - - *e.g.*, the use of concepts like “equally efficient competition,” “profit sacrifice,” and “counterstrategies.” As you probably know, before January of this year I spent almost 40 years as an antitrust trial lawyer (mostly for defendants). As an FTC Commissioner, I have a dual role – Commissioners determine what cases will be prosecuted by the Commission staff and they also sit as judges in administrative proceedings, reviewing the

decisions made by administrative law judges. But as I reviewed the paper it struck me that I would probably have reacted to it in the same way had I still been a trial lawyer. Regardless of roles, the critical ingredients of sound antitrust analysis are a sound legal theory supported by accepted economic thinking, facts to support that theory, and evidence to support those facts. The paper repeatedly emphasizes that.

Third, notwithstanding the increasing convergence, I concluded that we in the United States can learn from the experiences of the EC. As you know, we at the FTC and the Antitrust Division folks at the Justice Department are holding hearings on unilateral conduct ourselves. We seek, among other things, to better understand, and possibly to resolve, some of the issues that remain unsettled in analyzing that conduct. We think that is important not only in challenging the right conduct but in avoiding the error costs that attend imprudent challenges. We can learn from the productive discussion that the EC's paper has produced, in tackling the unresolved issues. In addition, the paper is well written. Complex economics concepts are made understandable not only to sophisticated economists but to people like me who are not economists. As one who spent a career trying to discuss antitrust with lay juries (without seeming to talk down to them), I appreciated the way it was written.

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Now let me please turn to some of the challenging and interesting issues that the paper raises. I don't have time to discuss all of them. But it seems to me the five most cosmic ones are the following.

First, when, if ever, is it appropriate to assess the legality of single-firm conduct on the basis of the effects of the conduct alone without first defining the relevant market in which they occur, the concentration in that market and the market share of the putative defendant? Our Supreme Court has repeatedly held that in cases brought under Section 1 of the Sherman Act (our equivalent of Article 81), the use of an abbreviated analysis can be appropriate when anti-competitive effects are apparent. *See, e.g., Nat'l Collegiate Athletic Ass'n. v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 99-100 (1984); *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 459 (1986); *California Dental Ass'n v. Fed. Trade Comm'n*, 526 U.S. 756, 769-771. However, even in that context, the Court has been somewhat opaque in describing the circumstances in which an abbreviated analysis can be employed and how abbreviated the analysis can be. In its most recent decision on the subject, the Court said that an abbreviated analysis is appropriate when someone with even a rudimentary understanding of economics could conclude that the arrangements in question would have anticompetitive effects on customers and markets. Given the wars that occur between economist expert witnesses, this test actually may be difficult to satisfy. The Court, however, went on to say that what is ultimately required is an inquiry “meet for the case” at hand. *California Dental*, 526 U.S. at 781. Is an abbreviated analysis ever “meet” for a single-firm conduct case? On the one hand, the Supreme Court said in the *Copperweld* case that our Sherman Act considers concerted action governed by Section 1 to be more pernicious than single-firm conduct governed by Section 2 (our equivalent of Article 82). *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984). That weighs against short-cuts in challenging unilateral conduct under Section 2. On the other hand,

the considerations of judicial economy that justify the use of an abbreviated analysis in Section 1 cases would seem to be applicable in Section 2 cases.

The issue under Article 82 seems equally knotty. On the one hand, the DG Competition paper suggests that market power may be evident from other proof besides market structure, concentration and shares. *See* DG Competition paper, *supra* note 1, at ¶¶ 24, 26, 32. However, the paper emphasizes at the outset that Article 82 speaks in terms of abuse of a “dominant” position, and it stresses that dominance is determined by reference to the market in which the defendant competes and the conduct occurs. DG Competition paper, *supra* note 1, at ¶ 11. Analysis of the language of Section 2 of the Sherman Act, which speaks in terms of “monopolization” and “attempts to monopolize” arguably yields the same conclusion – namely that the defendant in a Section 2 case must be shown to have a dominant position in the market before its conduct can be considered a violation. Thus, this issue does not just turn on what one considers to be sound economics. It also depends on what one considers to be sound statutory interpretation and jurisprudence.

Second, to what extent should the legality of single-firm conduct vary depending on the structure of the market in which it occurs or the ubiquity of the conduct? The DG Competition paper highlights the fact that Article 82 permits challenges to single-firm conduct that occurs in an oligopoly market if the conduct has anti-competitive consequences (describing those market conditions as “collective dominance.”) DG Competition paper, *supra* note 1, at ¶¶ 43-50. In fact, the paper indicates that in some circumstances a collectively dominant position may be easier to defend (for example by predatory pricing) than single-firm dominance. DG Competition paper, *supra* note 1, at ¶¶ 75, 128.

It is unlikely that unilateral conduct could be challenged under Sherman Act Section 2 based on abuses of collective dominance. On the one hand, in *American Tobacco Co. v. United States*, 328 U.S. 781 (1946), the Supreme Court allowed a challenge to seemingly unilateral conduct on the part of the members of the highly concentrated tobacco industry. *See also Toys “R” Us, Inc. v. FTC*, 221 F.3d 928, 934-36 (7<sup>th</sup> Cir. 2000) (finding evidence in Section 1 case of a horizontal agreement where defendant served as “ringmaster”). On the other hand, a number of more recent lower court cases have held that there is no such thing as a “shared monopoly” violative of Section 2 because the monopoly concept contemplates power of a single firm only. *Harkins Amusement Enters. v. General Cinema Corp.*, 850 F.2d 477, 490 (9<sup>th</sup> Cir. 1988); *Kramer v. Pollock-Krasner Found.*, 890 F. Supp. 250, 256-57 (S.D.N.Y. 1995); *Phoenix Elec. Co. v. Nat’l Elec. Contractors Ass’n*, 861 F. Supp. 1498, 1514 (D. Or. 1994); *Sun Dun, Inc. v. Coca-Cola Co.*, 740 F. Supp. 381, 390 (D. Md. 1990); *Consolidated Terminal Sys. v. ITT World Communs.*, 535 F. Supp. 225, 228-29 (S.D.N.Y. 1982). These cases are buttressed by Supreme Court decisions stating that parallel conduct in a concentrated industry is generally not sufficient, without more, to show a Section 1 violation. *Theatre Enterprises v. Paramount Film Distributing Corp.*, 346 U.S. 537, 541 (1954); *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 237 (1993). *But see Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 221 (1939) (condemning “interdependent conscious parallelism”).

With respect to ubiquity, what should be made of conduct that is benign when employed by a single firm in the market but may be pernicious when employed by all? For example, what if a large percentage of the dealers in a given geographic market induce all or almost all of the

suppliers of a product to award exclusive territories?<sup>3</sup> Using ubiquity as variable is debatable as a matter of economics. One might argue that ubiquity indicates that the practice in question is efficient. *See, e.g., Paddock Publications, Inc. v. Chicago Tribune Company*, 103 F.3d 42, 44 (7<sup>th</sup> Cir. 1996). On the other hand, if the practice is exclusionary and every supplier engages in it, as a matter of logic the result is likely to be foreclosure of the market to new entrants.

However, at least in the United States the courts have been reluctant to sustain challenges to ubiquitous conduct by a single firm when the same conduct by that firm alone would not be illegal on the ground that essentially makes the defendant liable based on the conduct of others. *Paddock Publications, Inc. v. Chicago Tribune Company*, 1995 U.S. Dist. LEXIS 15784, at \*12-13, \*33-35 (N.D. Ill. 1995), *aff'd* 103 F.3d 42; *see also Gilley v. Atlantic Richfield Corp.*, No. 98CV132 (S.D. CA Mar. 27, 2003) (order granting motion to dismiss), at 8-9. It also may be difficult to impose an effective remedy; ordering all firms to refrain from a particular practice may mean foregoing efficient conduct that benefits consumers, while choosing which firms can and cannot engage in the conduct and under what circumstances, without regulatory intervention that amounts to market engineering seems virtually impossible.

Third, to what extent should the legality of single-firm conduct depend on accounting cost analysis? There is a clear consensus on this score in the case of predatory pricing. Our

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<sup>3</sup> Over twenty years ago, the Justice Department specifically stated that ubiquity should be a variable when it issued its Vertical Restraints Guidelines over two decades ago. U.S. Dept. of Justice, Antitrust Division, Vertical Restraints Guidelines, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,105 at 20,582-83 (1985). The U.S. Department of Justice subsequently withdrew the Vertical Restraints Guidelines on August 10, 1993, but there was no indication that the ubiquity aspect of them had anything to do with their withdrawal. *See* Anne K. Bingaman, Antitrust Enforcement, Some Initial Thoughts and Actions, Address Before the Antitrust Section of the American Bar Association (Aug. 10, 1993) (rescinding the DOJ Vertical Restraints Guidelines), *reprinted in* 65 Antitrust & Trade Reg. Rep. (BNA) 250 (Aug. 12, 1993).

Supreme Court said in the *Brooke Group* case that predatory pricing needed to be below “some measure of costs” which the court left undefined. *Brooke Group*, 509 U.S. at 222. The DG Competition discussion paper goes a step further and says that is true not only of predatory pricing but of other forms of price-based conduct like loyalty rebates and bundling (sometimes referred to in the United States as “economic tying”). DG Competition paper, *supra* note 1, at ¶¶146, 154-156, 165. A United States appellate court rejected extending the below-cost pricing requirement in that fashion in the *LePage's* case, which involved the bundling of rebates. *LePage's Inc. v. 3M*, 324 F.3d 141, 147-153 (3<sup>rd</sup> Cir. 2003). But that debate is far from over in the United States. In response to our Supreme Court’s request for the government’s views about the soundness of the *LePage's* decision the government simply said that the issue was not yet ripe for consideration by the Supreme Court. U.S. Department of Justice and Federal Trade Commission, Joint Amicus Brief, *3M Company v. LePage's Inc.*, No. 02-18625, <<http://www.ftc.gov/os/caselist/3mvlepage/3mvlepage.htm>>.

There is also debate about what measure of costs is appropriate in determining whether prices are below “some measure of costs.” As I said, our Supreme Court has left that up in the air. The discussion paper tries to be more precise. It identifies five possible measures of cost – marginal cost (MC), average variable cost (AVC), average avoidable cost (AAC), long-run average incremental cost (LAIC), and average total cost (ATC), and it tries to identify the circumstances in which the use of each may be most appropriate. DG Competition paper, *supra* note 1, at ¶¶ 64-65, 106-110. AAC seems to be DG Competition’s preferred standard for predatory pricing, and it notes that the MC benchmark may be impractical because of the lack of available data sufficient to calculate MC. *Id.* at ¶ 107.

This discussion of the correct measure of costs may miss an important point. Professor Andy Gavil recently remarked that the defendant always prevails when the legal test for exclusionary conduct is predatory pricing – regardless of the exact cost measure used.<sup>4</sup> There may be a couple reasons for this remark. First, it may be just too difficult to obtain and to calculate a company’s costs in the real world. See *In the Matter of General Foods Corp.*, 103 FTC 204, 299-304 (1984). But see *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917 (6<sup>th</sup> Cir. 2005) (reversing district court’s grant of summary judgment against plaintiff low-fare airline that alleged that established airline competitor engaged in predatory pricing). Second, debates between experts about economic principles sometimes pale in comparison with the debates between experts about costing principles. The trier of fact may not be able to decide one way or the other and, as a result, the plaintiff won’t be able to carry its burden of proof. Hence, the defendant wins. So this debate makes one wonder whether requiring cost-based analysis is really a prescription for doing nothing.

This may be one reason why the FTC over two decades ago said that in attempted monopolization cases, it will analyze competitive effects before it assesses the legality of the challenged conduct. *General Foods*, 103 FTC at 309-10. The FTC stated that the more elusive assessment of a company’s costs can be avoided where no dangerous probability of successful predation is present. *Id.* And where it is present, the conduct (and intent) analysis can proceed on firmer ground. This may be one approach that the EU may wish to consider.

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<sup>4</sup> Andrew I. Gavil, “Are the Antitrust Rules for Monopolists Really ‘Unclear’ or ‘In Flux,’” Before the American Bar Association Section of Antitrust Law, Fall Forum (Nov. 15-16, 2005).

Fourth, should the legality of single-firm conduct always depend on proof that it has been exclusionary in effect – that is to say that it has actually excluded rivals or would-be rivals? That is the thrust of the DG Competition discussion paper, as its title implies. The paper also says that exclusionary effects can be inferred from intent, as intent is reflected in the defendant’s documents or statements or from a pattern of exclusionary conduct by the defendant. DG Competition paper, *supra* note 1, at ¶¶ 112, 140, 171. As a defrocked trial lawyer, I am impressed with this wisdom. But exclusionary effects are still treated by the paper as the *sine qua non* of illegality, both as to price based practices and as to non-price based practices like tying and exclusive dealing. One wonders if that might not be too narrow a focus to prevent some short-term harms to consumer welfare. For example, in our Supreme Court’s majority opinion in the *Jefferson Parish* case, our leading tying case, the majority said that the fundamental vice of illegal tying was that the practice “forced” customers to buy something they did not want to buy. *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 27 (1984). That can occur – at least in the short run – without the defendant being able to exclude competitors over the long run. The same thing can be said about exclusive dealing practices. Rivals may have available countermeasures, but it may take time to implement them, depending on the duration of the exclusivity obligations. In the meantime, the defendant may be able to engage in short-term supra-competitive pricing to the detriment of consumers.

This highlights a fifth fundamental issue. Should challenges be permitted to practices that the market may correct in the long run but which, in the meantime, are clearly injurious to consumers (or other customers)? This has been debated in antitrust circles for a very long time. In fact, I recall discussing it with Judge Easterbrook on a Conference Board panel on Business

Judgment several decades ago. It has never been answered definitively by our courts and it does not seem to me to be answered definitively by the discussion paper. It is such a fundamental issue for law antitrust law enforcement officials that the sooner it is answered definitively the better off we will all be.

As I said at the outset, this certainly does not exhaust the issues that are still open as respects the legality of single firm or unilateral conduct. And I'm afraid I have done precious little today to resolve the ones I have mentioned. Over the next six and a half years of my term in office I intend to devote a good deal of thought to them in hopes that I may contribute to their resolution or at least to the debate about them. In the meantime, I look forward to being educated both by the submissions at the hearings being held in the United States and by the excellent work that is being done on the subject of unilateral conduct by DG Competition and by the many practitioners commenting on the discussion paper.