Section 2 and Market Definition: First Principles and A Potential Approach

FTC/DOJ Hearings on Unilateral Conduct

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First Principles and History of Market Definition

- What is the most significant development in market definition analysis and/or jurisprudence in the last 30 years?
- Reason for success?
  - Understanding that tools should be designed to achieve a specific purpose
  - Agencies willing to be out in front of case law

First Principles: A Case Study on Market Definition

- The Horizontal Merger Guidelines
  - Built around 1st principles
    - The goal is to prevent mergers from increasing market power through coordinated interaction or unilateral effects
    - Market definition is a tool geared specifically to the overall goal of the HMGs.
      - Designed to identify the firms necessary to profitably engage in coordinated interaction or unilateral effects
      - For unilateral effects, can even be collapsed into competitive effects analysis.
    - HMG market definition is rigorous, logical and transparent
      - Permitted development of implementing tools even where approach not immediately operable in practice

Implications for Section 2

- First principles of Section 2
  - Goals
    - What are the goals?
    - Is there a consensus?
    - Lots of ink spilled over Trinko
      - Differences between DOJ and FTC
      - Profit sacrifice vs no economic sense vs disproportionate harm relative to efficiencies
  - Where does that leave us for market definition?

Options for Section 2

- Rely on the case law?
  - Where does reasonable interchangeability get you?
    - How much interchangeability is reasonable?
    - What is the algorithm that allows you to bound the market?
- Rely on the HMG market definition?
  - Does the hypothetical monopolist paradigm really apply?
  - Is the goal of section 2 the same as the HMGs?
    - HMG deals with collusion
    - Section 2 deals with primarily with exclusion

Potential Approach

- First principles
  - Possible goals of section 2
    - Prevent unilateral conduct that:
      1. Reasonably likely to significantly raise price or reduce quality
      2. (A) has no efficiencies, (B) disproportionately low efficiencies relative to anticompetitive effect, or (C) would make no economic sense in the absence of exclusionary effect.
      3. Permits recoupment of the cost of the exclusionary conduct.
    - Because #1 would seem to be a necessary condition, perhaps we can use market definition to identify instances in which alleged conduct could result in significantly higher prices
    - Would such a market definition need to change depending on choice of 2(A)-(C) and/or 3?
      - Probably not; these factors relate to what could be considered defenses or separate prongs of the analysis

Potential Approach

- Relevant context for measuring profitability of price increase?
  - Before, during or after execution of alleged conduct?
    - We are concerned with price going up as a result of the alleged conduct
      - So focus on whether significant price increase is profitable “during” or “after” alleged conduct
      - For unconsumated conduct, ask whether significant price increase would be profitable at a future time during or after alleged conduct is effective
      - Would not expect price increase to be profitable “before” if firm is profit maximizing – not informative
        - » Similar to HMG approach, which does not ask whether prices could be raised pre-merger
        - » Tells us nothing about effect of alleged conduct or merger

Potential Approach

- Apply Critical Loss Analysis to see if price increase is profitable in the period during or after alleged conduct
  - Burden on plaintiff to show:
    - The likely extent to which alleged conduct restrains 3rd party producers; and
    - That it would be profitable for monopolist to raise price significantly (10%?) as a result
      - Calculate critical loss for monopolist based on margins
      - Estimate whether a 10% price increase after or during the alleged conduct would leave sufficient residual supply such that monopolist would loose volume in excess of critical loss

Potential Approach

- Monopoly Power Determination -- Options
  1. Avoid market share analysis and collapse it into market definition analysis similar to what some have proposed for unilateral effects analysis in HMGs
     - Market share threshold unnecessary
  2. Market share threshold
     - Firms in market include those firms for which price increased (significantly?) as a result of the alleged conduct
     - Shares based on sales
     - But why have a share based requirement?

Summary

- Lessons from the HMGs
  - First principles and integrated approach should be considered
  - A theoretic framework would be important even if not immediately highly operable
  - Agencies should not be afraid to consider guidelines that deviate from the traditional case law

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