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2 and
3 UNITED STATES DEPARTMENT OF JUSTICE
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8 PREDATORY PRICING
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18 WASHINGTON, D.C.
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23
24 Reported and transcribed by:
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5 and

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9

10 PANELISTS:

11 Morning Session:

12 Patrick Bolton

13 Kenneth G. Elzinga

14 A. Douglas Melamed

15 Janusz Ordover

16

17 Afternoon Session:

18 Tim Brennan

19 John Kirkwood

20 Janet L. McDavid

21 Steven C. Salop

22 Frederick R. Warren-Boulton

23

24

25

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1 P R O C E E D I N G S

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3 MR. POTTER: Thank you for coming, everybody.
4 This is the first substantive hearing on predatory
5 pricing from the Section 2 hearings. My name is Bob
6 Potter. I'm the Chief, Legal Policy Section, Antitrust
7 Division, Department of Justice, and I will be the lead
8 moderator for this morning's session. Sitting to my
9 left is Pat Schultheiss, an attorney with the Federal
10 Trade Commission's Bureau of Competition's Office of
11 Policy and Coordination. She will be the co-moderator
12 for this morning and the lead moderator this afternoon
13 on the buy-side predatory pricing.

14 Before we start, just a couple of housekeeping
15 things that I need to say. One, for the courtesy of the
16 audience and the panelists, please turn off any cell
17 phones, Blackberries or other devices that may make
18 noise during the hearing.

19 Second, the restrooms. The men's restroom is
20 out the double doors to the left, on your left. The
21 ladies restroom is out the double doors, past the
22 elevator bank, to the left, and I saw this morning that
23 neither of them had hot water, so, if you want hot
24 water, you're out of luck.

25 MS. SCHULTHEISS: There is no place in the

1 building that has it right now.
2 MR. POTTER: Third, and perhaps most important,
3 in the unlikely event that there is an emergency in the
4 building, please calmly and quickly go out the doors to
5 your right and down the stairs. The Federal Trade
6 Commission has a policy of meeting in the Sculpture
7 Garden, which is on Constitution Avenue. If you don't
8 know where it is, just follow the line of people leaving
9 the building, and I am sure you will get there.
10 This morning, we are very grateful for having a
11 very distinguished panel to talk with us about predatory
12 pricing and Section 2. Our panelists are Ken Elzinga,
13 Professor Ken Elzinga of the University of Virginia;
14 Professor Janusz Ordover of New York University;
15 Professor Patrick Bolton of Columbia University; and
16 Doug Melamed of the law firm Wilmer Hale and former
17 Deputy Assistant Attorney General of the Antitrust
18 Division and Acting Assistant Attorney General of the
19 Antitrust Division.
20 The format for this morning is each of the
21 panelists will give a 10 to 15-minute presentation, then
22 we will have a short break, and then we will have sort
23 of a moderated round table discussion for the rest of
24 the time.
25 We want to thank the panelists. I'll introduce

1 them each before their speech as opposed to giving
2 everybody's introduction right now, and for the first
3 instance, I will tell you that although I'll give you a
4 short description, a much longer and better description
5 is contained in the biographical information that we
6 have.
7 Our first speaker this morning is Professor Ken
8 Elzinga of the University of Virginia. Professor
9 Elzinga is the Robert C. Taylor Professor of Economics
10 at UVA. He has a long and distinguished teaching career
11 at UVA, having been a faculty member there, although I'm
12 sure it doesn't look like it, for over 40 years.
13 Even more importantly for today's purposes,
14 Professor Elzinga is a creative and prolific academic
15 writer, having authored more than 70 economic articles,
16 a number of which have focused on predatory pricing.
17 In addition, perhaps even more importantly,
18 Professor Elzinga has been an expert witness in some of
19 the most important predatory pricing cases in the
20 history of antitrust, including Brooke Group,
21 Matsushita, and most recently, Spirit Airlines.
22 With that, please join me in welcoming Professor
23 Elzinga.
24 DR. ELZINGA: Thank you, Bob. I am going to
25 speak from the table here if that's all right, and I

1 have got 15 minutes, max, to talk about predatory
2 pricing. That's a big topic. So, hold on to your
3 seats.
4 As was mentioned, I was the economic expert for
5 the defendants in the last two Supreme Court cases on
6 predation, the first one being Matsushita -- that really
7 dates me for some people in this crowd -- and then
8 Brooke Group or what I still call Liggett v. Brown &
9 Williamson, and then also, as was mentioned, I was
10 involved more recently in a predatory pricing case,
11 Spirit Airlines v. Northwest. I did an economic
12 analysis for Spirit, a so-called low-cost carrier. This
13 case had a happy landing for Professor Ordover at the
14 district court level, it had a happy landing for me at
15 the circuit court level, and the final destination of
16 this case is still unknown, but I hope to make a few
17 remarks about it later.
18 When I first started speaking about this
19 subject, before a number of you in this room were even
20 born, there was not much economic analysis embedded in a
21 predatory pricing case. You basically answered two
22 questions. Were prices declining in the market -- not
23 necessarily below cost, mind you, just going down -- and
24 did the defendant generate documents with pugilistic or
25 militaristic metaphors? "We are going to cut off their

1 air supply. We are going to squish them like a bug."
2 If I had to pick two events, I am just doing a
3 brief intellectual history here, if I had to pick two
4 events that changed all this, it would be the Court's
5 opinion in Matsushita with its famous line that
6 predatory pricing schemes are rarely tried and even more
7 rarely successful. That statement was based on the
8 Court's exegesis of research about predatory pricing in
9 the economics literature. Almost all of this research
10 suggested that predation would be a strategy that would
11 be difficult to pull off.
12 And the second event was the publication of an
13 article by Don Turner -- the first Assistant AG to
14 enlist an academic economist in the front office, that
15 should always be pointed out -- and Phil Areeda in the
16 Harvard Law Review. It's the most often cited article
17 in antitrust scholarship, led to the Areeda-Turner Test.
18 Now, for this audience, I don't need to review
19 that article or that test, but let me mention for the
20 record how powerful was the hidden economic logic in
21 this famous test by using an iconic product from
22 Matsushita, a 19-inch black and white portable TV set, a
23 consumer electronic products my students today cannot
24 even imagine.
25 Let's say -- and these numbers are not way

1 off -- that this set was sold by Toshiba, one of the
2 defendants, to Sears for $95, and the average total cost
3 was $100, but the average variable cost was $90. So, we
4 have ATC equals 100, P equals 95, AVC equals 90. Almost
5 everyone at the time believed Toshiba was selling below
6 cost. After all, how could Toshiba survive with that
7 type of price-cost relationship? And it took an
8 instinct for economic reasoning or a recollection of a
9 price theory course to realize that such a price was
10 above the shut-down point, it was cash flow positive,
11 and that Toshiba was better off making the sale to Sears
12 than not making that sale, and the Areeda-Turner article
13 convinced a lot of people, including a lot of people in
14 this building and a building nearby, of something that
15 economists have known since Alfred Marshall, and that
16 is, in economics, what happens at the margin really does
17 matter.
18 What was missing from Areeda-Turner was a way of
19 thinking about the period of recoupment. They set the
20 stage for a more sophisticated -- I did not say highly
21 sophisticated -- but a more sophisticated economic
22 analysis that the Court adopts in Brooke Group. The
23 Court in Brooke Group recognized that even if a firm
24 charged a price below cost, whatever was the cost
25 benchmark, if the firm couldn't recover its losses, it

1 was difficult to make a case for antitrust enforcement,
2 because the aspiring predator would simply shoot itself
3 in the foot if there was no recoupment, and this
4 economic logic behind plausible recoupment entailed two
5 analytical constructs.
6 The first one is real clear in Brooke Group and
7 the second one is not transparent. The first is the
8 recognition that predation is like a capital
9 expenditure. In Brooke Group, the Court cites a paper
10 by David Mills and me entitled "Investment in
11 Predation." Economists have always recognized that a
12 dollar invested today requires more than a dollar in
13 future products because of the time value of money, and
14 Brooke Group understood that and applied that logic to
15 predatory pricing, that losses from predation need to be
16 recouped and not just on dollar-for-dollar basis.
17 The second point follows from the first: Unless
18 entry and exit conditions are symmetrical, the
19 recoupment returns for the aspiring monopolist must be
20 enjoyed for a longer time period than the time frame in
21 which the aspiring monopolist shouldered the cost of the
22 predation strategy, and I could just do a footnote here
23 on Matsushita and how much the world has changed.
24 The plaintiffs in Matsushita thought they were
25 making a good case for their side by arguing that the

1 Japanese charged prices below cost for years and years
2 and years, over a decade, not recognizing that the
3 longer is that time period, the more difficult it would
4 be -- indeed, I think mathematically impossible given
5 the power of compound interest -- to ever make up the
6 gains.
7 For those of you who are attorneys, and that
8 would be most of you in this room, I'll tell you what I
9 find to be a fascinating war story from Matsushita. I
10 did some back-of-the-envelope calculations as to what a
11 19-inch black and white TV set would have to sell for
12 under the plaintiff's argument that predation had gone
13 on for 15 years, that is, these sets had been sold below
14 cost for 15 years. What would a 19-inch black and white
15 TV set have to sell for? And I found it would be like
16 $800 into infinity.
17 Now, I don't know if this is one of the things
18 that economists talk about when we are not in the
19 presence of antitrust lawyers. The antitrust lawyers
20 thought, don't ever make that argument on the stand,
21 because the plaintiffs will say, well, even the
22 professor on the other side says the television sets
23 will sell for $800 a year into infinity because of this
24 case. And I said, no, that can't be. They can't sell
25 for that much. They sell for $100 now. They are not

1 going to go up to 800, trust me.

2 But my point is, the predator wants the period
3 of recoupment to be long, not the period of predation to
4 be long. The financial rewards that a successful
5 predator is going to enjoy is the present value of the
6 sum of each period's future return once the target has
7 conceded the battle.

8 Now, remember, a business firm has some hurdle
9 rate or internal rate of return before it signs onto any
10 investment project. Signing on for a predatory pricing
11 strategy to an economist is no different. The higher is
12 the hurdle rate, the bigger and longer the monthly
13 returns have to be during the period of recoupment.

14 And Grant, if you could show my first slide,
15 please.

16 In my experience, if one plays with the math
17 that I have at the top, which shows the monthly
18 sacrifice and the hurdle rate and the time period versus
19 the monthly return, it's hard to look at past episodes
20 of predation and come up with examples where recoupment
21 is mathematically possible. To my mind, when I try to
22 teach my students just the basic economics of the
23 elementary price theory level class, the important
24 asymmetry for predation is the one in the little box at
25 the bottom, if you can see it on the slide, slow entry

1 but quick exits by target firms.
2 Putting the math aside, putting even the
3 diagrams aside, if there is slow entry but quick exits
4 by target firms, then there's a possibility that
5 predation can be successful. There's got to be, in
6 other words, an economic asymmetry between exit and
7 entry conditions in the market, and think about what
8 that means. In most markets where entry is easy, exit
9 is easy. So, predation simply won't work in those
10 markets. And in like fashion, in markets where entry is
11 difficult, that helps an aspiring predator, exit will be
12 slow, and that is bad news for an aspiring predator.
13 So, what the successful predator needs is a market
14 setting where exit is quick, but entry or supply
15 expansion is slow.
16 Now, in the Spirit-Northwest case, one of the
17 factors persuading me that predatory pricing was
18 plausible or rational for Northwest was because the exit
19 of Spirit, that was the target LCC, the target low-cost
20 carrier, took place quickly, but re-entry and supply
21 expansion was difficult. Spirit Airlines pulled
22 capacity out of Detroit quickly when Northwest cut its
23 fares in the two markets that Spirit served, but Spirit
24 could not enter and expand rapidly during Northwest's
25 recoupment period, because Spirit faced an entry barrier

1 in the form of access to gates at the Detroit Airport.
2 Now, I went into the Spirit Airline case as
3 someone from Missouri or Chicago, maybe either metaphor
4 fits, but I ended up concluding that Spirit was a victim
5 of predatory pricing by Northwest, and I'll just say as
6 an aside, this is a case in which Fred Kahn should have
7 testified and not myself. Professor Kahn knows more
8 about the economics of airlines than most any group of
9 economists combined, but he was unable to participate,
10 though he was convinced that predation took place, as I
11 slowly -- kicking and screaming -- came to conclude.
12 The pricing trends in the Spirit case are a
13 textbook example of what predatory pricing would look
14 like. If I could have the first slide, this shows the
15 prices in the Philadelphia area -- I think the first
16 one -- yes, in Philadelphia. There were two city pairs,
17 Detroit, Boston and Philadelphia, and you will see that
18 Northwest prices in both of these are high. Spirit
19 enters; Northwest prices fall dramatically. Spirit
20 exits; Northwest prices jump up. If you show the other
21 slide, you will see basically the same scenario.
22 Now, these price trends -- I want to stress
23 this -- they are merely suggestive. They are not
24 dispositive of predatory pricing. Once a pricing
25 scenario like this is observed, then there follows the

1 mind-numbing exercise of comparing revenues with some
2 measure of variable costs, and this is a difficult task
3 in the best of circumstances. It is by no means simple
4 in the airline passenger industry. In the Spirit case,
5 this was a battle between Professor Ordover, Janusz, for
6 Northwest, and Dr. Dan Kaplan was the economist for
7 Spirit. There was also a recoupment analysis done by my
8 colleague David Mills.
9 Briefly, from my perspective, going back to the
10 little box on the bottom of my first slide, one key to
11 the success for Northwest was simply how quickly Spirit
12 exited and the duration of the recoupment period, and
13 that's consistent with the first slide that I presented.
14 I was going to show one more slide, but in the
15 interests of time, I am going to pass on that.
16 Let me conclude this way: Antitrust always has
17 surprises. That is one of the reasons I have enjoyed
18 being an antitrust economist all these years. Let me
19 close by mentioning the surprise for me in the Spirit
20 case.
21 At the last minute, Spirit's attorneys suggested
22 that a price below average total cost but above average
23 variable cost could be predatory, and the Circuit Court,
24 at the tail end of its opinion, seems to suggest that at
25 least in the market circumstances of this case,

1 Northwest's conduct may have been predatory even if its
2 fare structure exceeds, as the Circuit Court put it, and
3 I'm quoting here, "an appropriate measure of average
4 variable costs."
5 Now, Spirit's attorneys were pleased with this
6 little present, I am sure. I can restrain my enthusiasm
7 for the way the Circuit Court closed out its opinion.
8 This might take us into a more European view of
9 predation under Article 82, where prices greater than
10 average variable costs might be construed as predatory
11 and where, as I understand that in Europe, there is a
12 continued interest in intent documents and there is no
13 recoupment requirement, again, as I understand it.
14 Like most economists, I can restrain my
15 enthusiasm for the misuse of intent documents. I hold
16 the opposite view here of what had been the conventional
17 view in antitrust. To me, pugilistic and militaristic
18 metaphors are a welcome signal, not of predation, but of
19 competition in a market that doesn't have a stodgy "live
20 and let live" oligopoly setting, and where you see those
21 documents, to me, the prima facie case is that
22 consumers, albeit not rivals, but consumers are the
23 beneficiaries of head-to-head competition and not
24 predation.
25 MR. POTTER: Thank you.

1 DR. ELZINGA: Sure, thank you.
2 (Applause.)
3 MR. POTTER: Our second speaker today is
4 Professor Janusz Ordover. Professor Ordover is a
5 Professor of Economics and a former Director of the
6 Masters in Economics Program at New York University,
7 also Director of Competition Policy Associates in
8 Washington, D.C. I first met him when he was the Deputy
9 Assistant Attorney General for Economics in the
10 Antitrust Division.
11 While at the Antitrust Division, Janusz was a
12 member of the White House deregulation task force. He
13 guided economic analysis of antitrust enforcement and
14 acted as a major liaison between the Justice Department
15 and various regulatory agencies.
16 Professor Ordover has written extensively about
17 predatory pricing and has a great deal of experience as
18 an expert witness in predatory pricing cases. He was an
19 expert for the defendant in the Division's American
20 Airlines case, and he is, as Professor Elzinga said, an
21 expert in the Spirit versus Northwest case on
22 Northwest's behalf.
23 Professor Ordover, welcome.
24 (Applause.)
25 DR. ORDOVER: Well, while we're getting set up,

1 thank you very much. It's always a pleasure to
2 participate in these kinds of hearings.
3 Predation, of course, marks a lot of my
4 antitrust life. The first time I unveiled my thinking
5 on the subject of predation was about 1980 at the FTC
6 hearings on predatory conduct, and at that time, I think
7 I was attacked -- Professor Willig and I were attacked
8 by Frank Easterbrook, David Scheffman and Mike Scherer,
9 so essentially from left to right, everybody thought we
10 were completely foolish, and Mike Scherer said it was
11 the worst antitrust paper ever written, unlike the
12 Areeda-Turner paper, obviously, has its own different
13 reputation.
14 And then, just a few years ago, it was my
15 misfortune to fly into Ken Elzinga, who has never seen
16 predation other than the case that I was involved in.
17 Something is wrong here. So, I don't know what's wrong,
18 but I guess maybe I will switch careers in my waning
19 years.
20 In any case, what I wanted to do today is to
21 quickly run through some of the ideas that I have been
22 toying with in the antitrust predation field for some
23 past 20-some odd years and perhaps follow up on some of
24 the comments that Ken made, although I will not try to
25 relitigate Spirit versus Northwest. This will have to

1 await Northwest's exit out of bankruptcy. So, unless
2 they get into bankrupt predating, but you never know.
3 So, now we are in a holding pattern until somebody
4 coughs up some money and we can actually go back and
5 litigate the antitrust part of the airline life.
6 In any case, what I wanted to do was just go
7 through a few slides focusing essentially on some of the
8 issues that have been discussed over the years, and that
9 is how to analyze challenged conduct from
10 monopolization, particularly paying some attention to
11 predatory behavior.
12 I was going to simply jettison this whole talk
13 by simply saying one should have no price predation
14 cases, but I thought that would be too quick an exit, so
15 I have to torture you for a bit longer to convince you
16 maybe that we should think about it as a possible
17 solution to our woes in this antitrust patch, without,
18 at the same time, suggesting that we should throw out
19 all kinds of scrutiny of firms' conduct, which consists
20 of much more sophisticated pricing from other aspects of
21 what they do, behavior, what I would often call
22 competitive response package, which is I think a term I
23 coined for my testimony in U.S. V. American Airlines,
24 where actually American Airlines' behavior was not just
25 simply pricing but involved a lot of other things that

1 the Government alleged were designed to, in fact, retain
2 or maintain or defend American Airlines' position at its
3 hub, Dallas-Fort Worth.
4 So, I'm always thinking about competitive
5 response packages as strategies designed either to exit
6 the rival or to prevent the rival from coming in or
7 possibly designed to contain the rival, and I think it's
8 the last category of strategies which I believe is of
9 great interest and perhaps should be given a little bit
10 more time than we often do.
11 But in any case, the question becomes, how
12 should the decision-maker delineate conduct that does
13 not harm competition by harming scarce rivals from
14 standard, day-to-day market interactions? And
15 economists have been pulling their hairs out since
16 Areeda-Turner, 1975 paper, so we are now in 31 years, 30
17 years of thinking about it, and there is no solution as
18 evidenced by the articles in the latest Antitrust Law
19 Journal, where everybody is still fighting over
20 important things but without actually coming to any
21 particular conclusion.
22 I have been associated over the years with
23 something called the sacrifice test, but I always
24 thought of sacrifice test actually as a version of the
25 welfare test. In other words, what attracted me and

1 Professor Willig to thinking about the so-called profit
2 sacrifice approach to delineating procompetitive versus
3 anticompetitive conduct, or at least neutral from
4 anticompetitive conduct, was the notion that at least in
5 some well-defined range of circumstances, these two
6 tests ought to give a pretty close set of answers.
7 In other words, that one was not -- that is, the
8 sacrifice test -- was not somehow biased, setting aside
9 the difficulties of implementation, but it somehow was
10 not biased one way or the other against deterring what
11 would be anticompetitive conduct or what would not be
12 anticompetitive conduct, relating to too much conduct
13 that, in fact, would be harmful. We have been able to
14 show in a variety of circumstances -- in fact, these two
15 tests coincide for the very simple reason that a pursuit
16 of profit, which is the engine of market economies, in
17 fact, is a kind of behavior that generally or frequently
18 does, in fact, conduce to welfare maximization. Seeking
19 profit is a good thing, it is not a bad thing, and
20 therefore, it is not surprising that if you write down
21 your economic model correctly, or at least correctly for
22 the purposes at hand here, that in many circumstances,
23 these two tests will give you the same kind of answer.
24 So, there might be, however, a range of
25 circumstances in which these two tests fall apart by

1 virtue of the fact that the basic condition under which
2 they do coincide is potentially difficult to meet, and
3 that condition is incomprehensively stated as the third
4 bullet on this slide, but the basic idea here is that if
5 the incumbent firm can effectively, without creating
6 additional distortions, extract profits by its pricing
7 strategies and other strategies, then any strategy that
8 actually lowers the profits relative to that extraction
9 ought to signal, at least as a first step to the
10 analysis, ought to signal that a firm may have some
11 other aims in pursuing that strategy, something that I
12 think Bernheim and Whinston have now been calling over
13 the years as trying to create market power in what's
14 called a noncoincident market, okay?
15 So, the action takes place in market A, assuming
16 we have it well defined, but the goal essentially turns
17 out to be gaining incremental power or preventing
18 erosion of power in some other market, which Schullman
19 called a noncoincident market, let's say, which could
20 be, in Areeda-Turner world, it could be the same market
21 but in the future day, okay? So, what's the meaning of
22 noncoincident market is actually a little loose, but
23 that's the term that at least Berheim and Whinston in
24 their fine unpublished monograph on exclusionary
25 behavior utilized as a view for analyzing this kind of

1 situation.
2 So, it could be a setting in which the whole
3 thing works beautifully. An example is an inferior
4 source of supply, this is the second thing which I think
5 is quite ubiquitous, in which the incumbent firm is
6 faced with competition from another firm or a firm that
7 constrains its ability to exercise pricing freedom,
8 which provides an inferior product, and therefore,
9 enables the incumbent firm to earn supra-competitive
10 profits, at least profits higher than some rents, but
11 getting rid of that firm would, in fact, lift the
12 ceiling and therefore would enable the firm to raise the
13 price even higher.
14 The problem turns out to be that maybe exiting
15 that firm may be just very difficult; however, a
16 circumstance that we have analyzed, Willig and I, under
17 the rubric of systems competition, informs a view of the
18 circumstance in which actually disabling a component
19 that the other firm needs in order to be a full-fledged
20 parcel, bundle and bundle competitor with the incumbent
21 firm will, indeed, lift the ceiling and therefore enable
22 the firm to exercise incremental market power. So, the
23 idea that we have pursued, and the idea which I think is
24 actually fruitful, is that in many circumstances, the
25 goal of the competitive response package is not

1 necessarily to kill or to weaken or to disable the
2 person that or the firm against whom this conduct is
3 being perpetrated, but rather, to try to lessen or
4 weaken some other kind of restraint which cooperates
5 complimentarily with the firm whose market presence is
6 being weakened.
7 I think if you look at these Microsoft cases,
8 some of which were discussed along the same lines, this
9 is a fruitful way of thinking about it, but you can
10 immediately see that the economics of the situation is
11 much more difficult than the one instance in the
12 Areeda-Turner case, which is drop the price below some
13 level of cost, you go perhaps profit-negative, assuming
14 you know how to calculate profits, you know how to
15 calculate revenues maybe, you know how to calculate
16 costs maybe, and you can compare the two and see what
17 happens, you are losing money, and as a result of which,
18 it is anticompetitive.
19 But in the situation like this, you don't have
20 to be losing money on anything unless you try to look at
21 the situation in a somewhat different way, which is
22 where the efficient component pricing rule tells you how
23 to look at that situation that I have just described.
24 The efficient component pricing rule for those of you
25 who are not regulatory freaks like myself is a rule that

1 tells you what the price of a scarce bottleneck should
2 be if it does not involve any kind of profit sacrifice,
3 okay? So, ECPR is a way of thinking about pricing
4 access, pricing access to the component that is needed
5 in order for the firm to be a viable component system or
6 system competitor.
7 Another example along the same lines, which
8 again focuses on a complicated pricing strategy, not
9 simply dropping price below some measure of cost, was
10 discussed in Ortho v. Abbott. Actually, I worked for
11 Ortho in that case, and there the situation was, again,
12 packaged pricing of a very interesting kind, in part
13 interesting because the buyer insisted on firms offering
14 not only unbundled pricing, but also bundled pricing
15 with a different number of components put in. The buyer
16 needed to buy five tests. There was a regulatory
17 presence out there that required that every blood
18 screening used five tests at that time, I think now it's
19 six, and Abbott was the one that could offer five of
20 them, Ortho could only offer three.
21 Then the question was, could Ortho compete
22 against Abbott if it did not get the access to the
23 remaining two, either because the buyer could create the
24 bundle or because Ortho could buy the necessary input
25 and then resell the bundle? Again, in this case, it

1 turns out that there is some discussion that potentially
2 Abbott was pricing the incremental two tests at levels
3 that were unprofitable, that violated some version of
4 what we called a second ago the efficient component
5 pricing rule.
6 What was very complicated in that case was, A,
7 that Ortho did not give me any cost data. So, I
8 couldn't say anything, whether it was true or not, but I
9 did derive the test on a napkin, so other than the
10 Laffer Curve that also was derived on a napkin, this is
11 probably the second most famous napkin in the history of
12 economics. But in any case, the point I'm making is
13 that in this case at least we had a way of dealing with
14 an issue, but we had no reason to explain why this was
15 going on, and I think that's a very important aspect of
16 any predation case, which is that the plaintiff makes a
17 clear connection between the conduct that is at issue
18 and the anticompetitive impact that is being challenged
19 as leading to this anticompetitive outcome down the
20 road.
21 Virgin versus BA, another complicated case that
22 pitted Bernheim against Schmalensee, actually a
23 beautiful battle -- I think it was Schmalensee -- of
24 battle in IO, in which, again, there was no simple
25 pricing strategy, but rather, a complex pricing strategy

1 that Bernheim showed leads to an equilibrium in which
2 there's relatively cheap exclusion but in which no price
3 is technically below marginal cost, simply understood,
4 yet as we know, all of these tests that we have in front
5 of us do have some flavor of comparing something to
6 cost, and again, what Bernheim tried to demonstrate in
7 that case, that a simple comparison of price to
8 something like marginal cost may be a flawed way to go
9 if you put that pricing in a strategy that British
10 Airways allegedly developed in a broader context.
11 Quantity-forcing contracts, I think we will skip
12 that, only because we have to, A, rush, and B, we will
13 talk about it in the fall, so I am going to skip that
14 unless it comes up in questions.
15 Just because I don't believe that true price
16 predation is an antitrust offense that is of great
17 interest, it does not mean that we as economists and you
18 as enforcers do not have plenty to focus on. I believe
19 that business strategies, these competitive response
20 packages, that have a strong commitment value, are
21 actually a more relevant focus than just simply pure
22 price predation, which creates all types of problems as
23 these papers in ALJ demonstrate.
24 Commitment to discount, which is Virgin versus
25 BA, commitment to product design, commitment to defend

1 lucrative markets, which I call the "new era" tying
2 models, network economies, commitments to effectively
3 raising rival's cost of competing, are the types of
4 strategies that we are now slowly beginning to
5 understand with the help of very fancy economic models
6 and beautiful game theory.
7 The question that I think we will have to leave
8 for Patrick to help us answer is whether or not we can
9 actually fashion workable tests that will take into
10 account these kinds of complications that economists
11 have been focusing on.
12 Thank you.
13 (Applause.)
14 MR. POTTER: Thank you, Janusz.
15 Our next speaker is Professor Patrick Bolton.
16 Professor Bolton is the David Zalaznick Professor of
17 Business. He began as Assistant Professor at U-Cal
18 Berkeley, then moved to Harvard. Then he was the John
19 H. Scully Professor of Finance and Economics at
20 Princeton University.
21 Professor Bolton's research and areas of
22 interest are in contract theory and contracting issues
23 in corporate finance and industrial organization. One
24 of his particular areas of research is the impact of
25 strategic economic game models on predatory pricing

1 theory.
2 Professor Bolton, welcome.
3 DR. BOLTON: Thank you, Bob. It's a pleasure
4 and an honor to be on this panel.
5 Unlike Professors Elzinga and Ordover, I have no
6 experience as an expert, haven't had that pleasure, and
7 if you want, I'm a new entrant. We will see whether
8 this will elicit predatory response from the economists.
9 So, my interest, as Robert just alluded to, my
10 interest in this topic came from reading the original
11 McGee article, which claimed that predation couldn't be
12 a rational economic strategy, and, you know, I read this
13 article again and again, and I just was not convinced,
14 and this led me later on to write a theory piece with
15 David Scharfstein where we outlined how predation could
16 be a rational strategy if it took the form of financial
17 predation, and I will say a little bit more about that
18 in my presentation.
19 And then later, I had the good fortune of
20 meeting with Joe Brodley, who introduced me to the new
21 developments in policy under Brooke Group and
22 highlighted some of the problems with the new policy and
23 also some of the new opportunities and challenges, and
24 that then led to our, in my view, very fruitful
25 collaboration on our article, which I will make the

1 centerpiece of my brief presentation today.
2 So, I thought I would start by saying first, you
3 know, where are potential areas of agreement among
4 economists and legal scholars and where there are still
5 areas of disagreement. I would argue that this is
6 relatively easy, that we are all in agreement on the
7 general definition on predatory pricing. Namely, it's a
8 price reduction that is only profitable because of the
9 added market power the predator gains from eliminating,
10 disciplining or inhibiting the competitive conduct, and
11 to summarize what both Professors Elzinga and Ordover
12 said earlier, you can distinguish two phases in any
13 predatory pricing episode, a sacrifice phase and a
14 recoupment phase. As Professor Elzinga wrote elsewhere,
15 you can think of predation as an investment in market
16 power. So, I would say that there is general agreement
17 on this characterization.
18 Where there is more disagreement is on policy,
19 and, well, there had been long disagreements on basic
20 economic premise, whether predation is an economically
21 rational strategy and how prevalent predatory pricing
22 episodes are. My sense is that this is an area of
23 convergence, at least on the first bullet point. I
24 think nowadays it is more and more widely accepted that
25 predation can be an economically rational strategy.

1 On the second bullet point, I think there are
2 still some areas of disagreement, but I would argue that
3 over time, things have moved in the direction of
4 thinking of predatory pricing as being more prevalent
5 than we thought before and also more likely to succeed
6 than we thought before, in part because our initial
7 beliefs were built on writing, McGee's writing,
8 suggesting that it couldn't be rational, and those
9 writings, I would argue, are now obsolete.
10 There are, however, still very sharp
11 disagreements on the legal standard. Some people argue
12 that we should have simple rules. Others have argued
13 that we should always err on the side of
14 under-deterrence to reduce the risk of false positives,
15 and the policy under Brooke Group is characterized as
16 both being simple and under-deterring. I would argue
17 against this.
18 Now, let me skip the description of Brooke
19 Group, because I imagine most of you are familiar with
20 it, so it involves both a cost test and a recoupment
21 test, and let me emphasize potential problems first with
22 the new policy, and namely, when we look at the facts on
23 what happened post-Brooke, what we find is that since
24 Brooke, plaintiffs have not prevailed in a single case,
25 and almost all cases have been decided by summary

1 judgment, and it is only very recently that we are
2 seeing some action on predatory pricing, particularly in
3 the case of Spirit versus Northwest.
4 So, what are the problems with the present
5 policy? Well, first of all, and I think we will discuss
6 this later on in the question time, I would argue that
7 the basic problem with the present policy is that the
8 cost test is highly unreliable. Professor Elzinga
9 earlier qualified proving a cost test as a mind-numbing
10 exercise. I would fully agree with that. I would say
11 that when you go into the details of trying to prove a
12 cost test, you will lose track of the economics of the
13 problem and of the case, and in particular, a very
14 narrow interpretation of the cost test, price being
15 below average variable cost, is a very poor proxy for
16 measuring profit sacrifice, which is what we are trying
17 to go after.
18 Another problem with current policy, we have
19 never gone to a point where we had to ask about a
20 possible efficiency defense on the part of the
21 defendant. There has never been any talk of applying
22 the same rigorous recoupment criteria that the plaintiff
23 has to fulfill on the defendant in proving an efficiency
24 defense. I would argue we should go in that direction.
25 But just to emphasize, I think that the major

1 problem with present policy is its failure to focus on
2 the main issues, and those are what is the predatory
3 strategy, what strategy drives alleged predation, first
4 of all, and second, what are the possible dynamic
5 efficiencies and how do you balance procompetitive and
6 predatory effects? And this is where our article takes
7 off and proposes an alternative approach, which I would
8 summarize as taking away some weight off the cost test
9 and emphasizing instead intent, bringing back intent,
10 but intent as structured by an economic analysis, and so
11 this is what in my short time I want to briefly go into.
12 So, specifically, we are thinking that any
13 approach based on intent should be based on strategic
14 analysis of predatory pricing, and in our article, we
15 emphasize at least two well-proven strategies, which are
16 financial market predation and reputation effect
17 predation. We also discuss test market predation. Of
18 course, as Professor Ordover highlighted, predation can
19 take many different and complex forms, and one should
20 not necessarily reduce one's self to just those few
21 strategies, and one should allow for any
22 well-articulated and rational strategy that might be
23 used. I might comment on that later on.
24 Anyway, so what we argue in our paper is that
25 this approach has two advantages. One is that it can

1 reduce the risk of false positives, and second, that it
2 puts the spotlight back on what we are really trying to
3 determine, which is discriminate between procompetitive
4 and anticompetitive effects, and there we can use intent
5 as our guide, evidence of intent as a guide to possible
6 defense, and what I mean by intent is not what Professor
7 Elzinga has referred to as militaristic and pugilistic
8 language, but evidence of a deliberate effort to exclude
9 and evidence of pursuit of a predatory strategy.
10 So, in our article, we outline five legal
11 elements to a predatory pricing test. Let me enumerate
12 them first, and then I will go into some of them in more
13 detail. The first element, which is straightforward, is
14 there should be a facilitating market structure. The
15 second element is the scheme of predation and supporting
16 evidence. Third, probable recoupment. Fourth, price
17 below cost. And those four elements would constitute a
18 prima facie case of predatory pricing.
19 I have put the fourth element in brackets here
20 to emphasize the fact that we try to de-emphasize the
21 cost test, and we would agree with the appeals court
22 opinion in the Spirit Airlines case that predatory
23 pricing which is above some measure of average variable
24 cost but below average total cost, that kind of pricing
25 could be predatory. Then, however, we add, if you

1 de-emphasize the cost test, we want to add as a safe
2 harbor the -- allow for an efficiency defense.
3 So, how do we prove those elements? Well, some
4 of them are straightforward, and I will not go into --
5 so, facilitating market structure is any evidence of
6 market power. The scheme of predation and supporting
7 evidence, I want to give you an example of how you go
8 about doing this. So, I will in particular take out of
9 our article the example we have on financial market
10 predation, and so under this element, what is important
11 is to establish that the conditions to implement a given
12 strategy are present and to provide direct or
13 circumstantial evidence showing that this strategy is
14 being implemented.
15 Recoupment, again, this is relatively
16 straightforward. You would want to show evidence of
17 exclusion and disciplining of rivals, and we stressed
18 the idea that second, that you should emphasize probable
19 recoupment instead of actual recoupment, because what
20 matters is whether at the time when this strategy was
21 being chosen, whether at that time, at the time of the
22 information the incumbent had at that time, whether it
23 made sense to implement such a strategy, and we know, as
24 in our own investments in finance, we know that at the
25 time when we make a decision of investment, we make an

1 analysis using this kind of cash flows that suggests
2 that we have a positive net present value investment,
3 but that is no guarantee that when we actually undertake
4 the investment, it will end up being profitable. So, we
5 would emphasize probable recoupment, and in particular,
6 put a lot of weight on market structure that makes
7 recoupment likely in the future.
8 Let me also emphasize here the "or related" in
9 brackets, and this is a point that Professor Ordover
10 emphasized, that recoupment shouldn't just be seen in
11 the narrow market where predation takes place. It could
12 be obtained in a related -- I forget the term you
13 used --
14 DR. ORDOVER: Noncoincident.
15 DR. BOLTON: -- noncoincident market.
16 On price below cost, I do not have much to add
17 to what I have said already except that in the paper we
18 emphasize that a better measure than average variable
19 cost would be average avoidable cost, and a better
20 measure for long-run average cost would be long-run
21 average incremental cost. I do not want to go further
22 into this, because making fine distinctions about these
23 definitions could end up being a mind-numbing exercise,
24 and it just highlights the difficulty with applying the
25 cost test.

1 So, what I would like to emphasize, though, is
2 that we would argue that failure to meet the cost test,
3 in particular, failure to establish pricing below
4 average variable cost, should not be grounds for a
5 dismissal on summary judgment and that, in fact, the way
6 to go would be to balance the cost test with an
7 efficiency defense. So, I would argue that if you are
8 able to show that there was pricing below average total
9 cost but above average variable cost but that there was
10 absolutely no efficiency defense, plausible efficiency
11 defense provided, that that would then make a strong
12 case for predatory pricing.
13 So, the efficiency defense, we spent a lot of
14 time in the paper on that, because one of the weaknesses
15 of the policy under Brooke Group and the Areeda-Turner
16 Test is that it really neglects looking at efficiencies,
17 and so we would argue that an efficiency defense does
18 provide safe harbor in itself for price competition that
19 benefits consumers, and we distinguish between defensive
20 defenses and market-expanding defenses and provide in
21 the paper an approach to proving those defenses. So,
22 defensive defenses, we mean by unilateral best response
23 mainly and minimizing losses from unexpected market
24 developments, and as for market-expanding defenses, we
25 really mean here promotional pricing, learning-by-doing,

1 and network externalities.
2 So, let me move on perhaps in the few minutes
3 that I have left with an illustrative example. How do
4 you prove financial market predation in a particular
5 case? So, very briefly, the theory here, you know, what
6 is financial market predation, why does it work?
7 Well, the reason why it works is because in
8 corporate finance, there are imperfections -- and there
9 is enormous literature on this -- there are
10 imperfections in capital markets due to agency problems
11 in lending, and as I have argued and have written in my
12 paper with David Scharfstein, a predator can take
13 advantage of those imperfections and drive out an
14 entrant by basically drying up financing.
15 So, how do you go about proving financial market
16 predation? So, we distinguish five essential
17 preconditions. One, the prey's dependent on outside
18 financing. The prey's outside funding depends on its
19 cash flow. Three, predation will reduce the prey's cash
20 flow sufficient to threaten its continued viability.
21 All these are fairly straightforward. Four, the
22 predator knows of the prey's dependence on outside
23 funding or can be assumed to know based on easily
24 accessible facts or rational conjecture. And five, the
25 predator can finance predation internally or has

1 substantially better access to external credit than the
2 prey.
3 I think in the Spirit Airlines case, I quickly
4 looked at it, most of these elements you would be able
5 to establish.
6 So, the example we have in the paper is about
7 entry into the cable TV market in Sacramento. This is a
8 case that predates Brooke, and here are the facts. So,
9 this is an entrant with outside financing amounting to
10 $6 million, entered in a small district in the
11 Sacramento area, the Arden District, serving 5000 homes,
12 and the entrant's intention was, of course, to reach a
13 bigger market share and expand gradually in the
14 Sacramento area. The incumbent Sacramento TV company
15 responded to this entrant with drastic price-cutting,
16 and after eight months, the entrant exited. So, how
17 would we prove a scheme of financial predation here?
18 Well, first of all, the dependence on outside
19 funding, what do we know? What are the facts here?
20 Well, first of all, the prey obtained funds through a
21 loan, and the entrant's owners were unwilling to commit
22 more capital than they had initially. Secondly, outside
23 financing depends on cash flow. Well, the incumbent
24 targeted its price reductions on the entrant's customers
25 and potential customers, and that obviously had the

1 effect of reducing cash flow. Predation will reduce
2 cash flow and threaten viability. Again, that is easy
3 to establish in this case.
4 The predator knows of the prey's dependence on
5 outside funding. Well, here it turns out there is
6 evidence, intent evidence, memorandum from the
7 incumbent's files that speaks of sending a message to
8 the entrant's bankers. Well, that's relatively easy to
9 establish here. And then finally, the predator has
10 better access to credit than the prey. Again, that is
11 an easy proof in this particular case.
12 So, let me -- sorry for having stepped over my
13 time -- so, let me just quickly conclude with
14 highlighting one potential concern with our approach,
15 and that is something that Posner mentions in his second
16 edition of his antitrust book, and he argues that one
17 concern one might have with evidence of intent is that
18 it's really "a function of luck and of defendant's legal
19 sophistication." So, we would argue that this concern
20 is reduced if the plaintiff is also required to prove,
21 as we articulate in our article, all the other elements,
22 and if what you are required to establish is the
23 implementability of a rational predatory strategy.
24 So, let me end with that.
25 MR. POTTER: Thank you very much.

1 (Applause.)
2 MR. POTTER: Our final speaker today is also the
3 only lawyer on the panel, although Doug is very used to
4 dealing with economists, so I am sure it will not be a
5 problem for him to follow them.
6 Doug is a partner at Wilmer Hale, and he is the
7 co-chair of the firm's Antitrust and Competition
8 Department. He has significant experience in a number
9 of government investigations, both government and
10 private litigation, substantial antitrust counseling,
11 and some of that counseling in investigatory work, in
12 litigation work, has involved predatory pricing.
13 From 1996 to 2001, Mr. Melamed served as the
14 Principal Deputy Assistant Attorney General in the
15 Antitrust Division and then as the Acting Assistant
16 Attorney General in the Antitrust Division. He's a
17 prolific writer, a frequent speaker, always has
18 interesting viewpoints that are well thought out. His
19 most recent --
20 MR. MELAMED: Don't raise the bar, please.
21 MR. POTTER: -- his most recent article, which
22 appears in the summer 2006 Antitrust Law Journal
23 provides a thought-provoking commentary on whether there
24 are unifying principles under Section 2.
25 Mr. Melamed, welcome.

1 MR. MELAMED: Thank you.
2 Well, I am a lawyer, and much though I enjoy
3 listening to economists and talking to them, I am going
4 to be talking as a lawyer now and giving a lawyer's
5 perspective on some aspects of the predatory pricing
6 issue.
7 Let me start by saying, I think Brooke Group was
8 correctly decided, an important decision, it brought
9 needed rigor and order to predatory pricing law, but I
10 am concerned about what has happened to it in the life
11 of the law. There is a kind of -- I do not know if this
12 is the right word -- a kind of rarefaction of Brooke
13 Group that I think has done some mischief, and let me
14 tell you what I mean.
15 As everyone knows, Brooke Group has proven to be
16 a defendant friendly standard. As Professor Bolton
17 noted, no plaintiff has won a predatory pricing case
18 post-Brooke Group. Not surprisingly, therefore, when
19 price is an element of the allegedly unlawful strategy,
20 the defendant argues that the standard to be applied by
21 the Court should be Brooke Group, and, of course, they
22 are entitled to do that, because if that's the law, they
23 ought to make that argument, and certainly I have done
24 that myself.
25 But if it is not a straightforward price-cutting

1 case, if it is a little complicated, the plaintiff says,
2 "No, no, no, this was different, bundled discounts,
3 aggressive buying, low prices conditioned on exclusivity
4 or other preferential treatment and so on." So, you
5 have a legal dispute. Does Brooke Group apply? Is this
6 the right category, predatory pricing, in which Brooke
7 Group applies, or does the conduct at issue belong in a
8 different category?
9 And there is a kind of a notion that there is an
10 apparent precision of Brooke Group, the price-cost test
11 and the recoupment test, that is uniquely valuable but
12 uniquely applicable to predatory pricing, and one
13 consequence of this is that when the Court decides in
14 this kind of stovepipe analysis that the conduct before
15 it really should not be considered predatory pricing,
16 too often, courts seem to find themselves in a kind of
17 "deer in the headlights, what do I do now" posture, and
18 the result is incoherent decisions like LePage's or
19 courts affirming nonsensical and meaningless jury
20 instructions like Weyerhaeuser and basically a casting
21 about in the way that Professor Elhauge had spoke of
22 Section 2 as a kind of incoherent mess.
23 I think this stovepipe or essentialist way of
24 looking at predatory pricing has created these kinds of
25 dichotomies as categorization, and it has inhibited the

1 development of a more robust antitrust jurisprudence,
2 one that can help courts make reasoned decisions about
3 conduct that they do not think falls into a precise,
4 well-established category, whether it be exclusive
5 dealing or predatory pricing or whatever.
6 Put differently, instead of inducing from Brooke
7 Group principles of broader application in the kind of
8 common law tradition which antitrust has in other
9 contexts involved, the process seems to have separated
10 predatory pricing from other forms of exclusionary
11 conduct, and it's done so because there has been in what
12 I call this rarefaction a number of propositions about
13 predatory pricing that are taken for granted or thought
14 to be true or thought to be unique to predatory pricing,
15 and I want to express some skepticism about that. There
16 is a lot of these propositions I have in mind, four or
17 maybe three depending on my time, and I want to express
18 skepticism either that they are true or that they are
19 unique to predatory pricing or perhaps both.
20 So, proposition one, to apply the price-cost
21 test, we need to select some term of art from the
22 economists as our measure of cost, average variable cost
23 or something like that. Now, this is a big topic. I
24 will make just a couple observations.
25 Almost everyone seems to agree that some kind of

1 incremental cost is the right measure, because we want
2 to know whether the allegedly predatory sales cost so
3 much that either the defendant must have intended some
4 predatory scheme or, at the very least, that the cost of
5 the sales exceeded the amount consumers were willing to
6 pay for them and therefore resulted in a welfare loss.
7 Areeda and Turner say, "Well, marginal cost is
8 the right test, but it's hard to prove, so let's use
9 average variable cost as a proxy," and now we have this
10 debate for 30 years, "Well, average variable cost really
11 isn't a good proxy, we should use average long-run
12 incremental cost or average total cost, may depend on
13 the circumstances," and you all probably read the
14 article, too, the discussion paper which went through
15 this discussion at great length.
16 Why are we even having this conversation? Why
17 are we debating these categories about technical
18 economic jargon that might have made sense in the
19 Areeda-Turner world in 1975, a simple static price
20 series model, and you can draw the ABC curve, the
21 marginal cost curve, and you can talk about these
22 metaphors, what's going on in the real word, but that
23 doesn't make any sense in the real world as I have
24 experienced it as a lawyer.
25 Areeda talked about additional increments of

1 output. I have rarely had a client say to me, "I'm
2 thinking of pushing more widgets off my production line.
3 How low can I go in price?" That's not how the problem
4 comes up in the real world, and if it looks like that,
5 there's a lot more going on.
6 The kind of predatory pricing problems I've
7 counseled clients on in recent years are things like
8 this: Price offerings to early adopters in a de facto
9 standards war; prices in two-sided markets; decisions to
10 assign a plant or an airplane to one market or one
11 segment rather than another. In these situations, I
12 think these terms of art that economists have, they are
13 very valuable in their models and their heuristic
14 exercises, don't have much value, and even if they have
15 value to the economists, they don't have much value to
16 the lawyer and the client.
17 What I find is valuable is saying to the client,
18 when I'm talking about costs, "What are the costs you
19 are incurring to engage in the strategy at issue that
20 you wouldn't otherwise have incurred?" Clients
21 understand that question, and it's not always a trivial
22 question, but I think it's one they can answer. So, I
23 think avoidable costs -- and I don't mean that as some
24 technical term, I mean simply as the but for costs of
25 the allegedly unlawful conduct -- is the cost measure,

1 okay?
2 Proposition two, price-cutting is beneficial to
3 consumers, so we should therefore have a standard that
4 errs in favor of avoiding false positives. Then Judge
5 Breyer, in the wonderful "bird in the hand" metaphor, I
6 think most famously perhaps articulated that.
7 Here is my concern: Sure, price-cutting is good
8 for consumers, no question about that. So are all sorts
9 of other things that companies do for consumers. In
10 fact, as I understand, from what the economists tell us,
11 that innovation does a lot more for welfare than
12 improving allocative efficiency by some price cuts and
13 supra-competitive down toward competitive levels. So,
14 why don't we -- and innovation, by the way, could be
15 inventing the PC or it could be coming up with an
16 improved method of distribution because of tying
17 arrangements or because of exclusive dealing. It could
18 be anything that improves the value of the product to
19 consumers.
20 In fact, cost of sale reductions could be
21 beneficial certainly to a total welfare sense and
22 ultimately to consumers as well. So, why do we single
23 out price-cutting, which I don't think has any unique
24 benefits to consumers?
25 Now, there is one thing about price-cutting that

1 is different, and that is it's unambiguously in the
2 interests of consumers. A product improvement, you
3 know, the car with the air conditioner might look like
4 it's better, but maybe consumers would rather have
5 better mileage. So, there is some ambiguity about
6 whether other forms of conduct benefit consumers, but
7 why do we have a legal superstructure built on the
8 premise that pricing is unique?
9 At some point, if we do that simply because it's
10 easier to identify the consumer benefit, don't we begin
11 to look like the economists searching for the keys under
12 the light post? At the very least, when the defendant
13 is able to show that his conduct is benefiting
14 consumers, why treat predatory pricing any differently?
15 Proposition three, the recoupment requirement is
16 central to and a great contribution to predatory pricing
17 law. Let me be clear. I strongly believe there should
18 be something like a recoupment requirement at least in
19 the sense of a market power screen; that is to say, a
20 plaintiff ought to have to prove that the allegedly
21 predatory scheme will pay off for the defendant by
22 creating additional market power or preserving market
23 power that will guard against -- kind of belt and
24 suspenders -- a mistake in the application of the
25 price-cost test, and it will preserve antitrust

1 violations for those cases where there is competitive
2 harm, and we won't worry about the others.
3 I think, in fact, there should be such a screen
4 in all cases of exclusionary conduct. The problem is, I
5 think in many quarters, including some of my
6 predecessors this morning, the recoupment test is
7 understood to mean that the plaintiff should prove,
8 should quantify, the defendant's investment in the
9 predatory strategy and then quantify his
10 supracompetitive returns during the recoupment period,
11 discount them by risk and uncertainty and time, and
12 conclude that the recoupment exceeds the investment.
13 Now, I think evidence of that sort, on that
14 issue, whether introduced by the plaintiff or the
15 defendant, should be relevant in a predatory pricing
16 case, because it certainly illuminates the likelihood
17 that what is going on here is some exclusionary conduct,
18 but I am very skeptical of the notion that that should
19 be an element of the offense. It clearly complicates
20 the proceedings, increases costs. It may be an
21 impossible burden for the plaintiff in a multi-market
22 reputation effect recoupment story.
23 If taken literally, you would have to go to a
24 profit-maximizing standard to figure out the defendant's
25 investment in the predatory strategy, because you

1 wouldn't be asking simply what did it cost him below
2 cost, you would be asking how much in profits did he
3 sacrifice. It's not necessary in order to identify
4 anticompetitive conduct, because if we think we got the
5 price-cost test right and the guy is selling below cost,
6 you can actually, it seems to me, infer that he expects
7 to recoup. It's not needed, because the market power
8 screen will identify the cases of competitive harm. And
9 finally -- and this is a point that I don't know that
10 it's original to me, but I haven't seen it before -- I
11 think it is an illusion that we're measuring something
12 about the welfare effects of the conduct when we use a
13 recoupment screen.
14 The welfare question in predatory pricing is
15 whether the welfare gains, consumer or total, during the
16 rivalry period, the competitive period, are greater than
17 or less than the welfare costs, consumer or total,
18 during the recoupment period, but the recoupment test
19 doesn't measure either of those. The recoupment test
20 measures producer surplus in the competitive period
21 versus producer surplus in the recoupment period, and it
22 doesn't take a whole lot of imagination to think of
23 situations where the results could be different, where
24 you could have, for example, recoupment but no welfare
25 loss from an allegedly predatory strategy.

1 So, proposition four, in applying the Brooke
2 Group price-cost test, the price of the product at issue
3 is the appropriate price to compare to cost. That in my
4 view is only partially correct. Obviously you look at
5 the price of or the revenues generated by the additional
6 sales attributable to the predatory conduct. You don't
7 look at the price of, of course, the inframarginal
8 units, the units that would have been sold anyhow,
9 because those units didn't exclude the rival or at least
10 they didn't exclude them by reason of the
11 anticompetitive conduct.
12 But that's not all there is to it. Suppose
13 we're in a two-sided market. Suppose you're cutting
14 price on circulation of the newspaper in order to
15 generate more readers and therefore more advertising
16 revenues. Surely you want to take into account the
17 incremental advertising revenues.
18 Suppose you have complimentary revenues. You
19 know, the Government didn't accuse Microsoft of
20 predatory pricing because the browser was free when
21 bundled with the operating system. Because it was a
22 plausible story that it increased revenues, we didn't --
23 increased revenues for the operating system. What about
24 revenues lost from inframarginal sales; that is to say,
25 the sales that the defendant would have made anyhow even

1 if he had not engaged in the predatory scheme, but he
2 would have made them at a higher price if he hadn't cut
3 prices?
4 To me, another way of putting that question is,
5 are we concerned with the incremental revenues or the
6 revenues from incremental sales? The law chooses wisely
7 in my view the latter. It ignores the loss of
8 inframarginal revenues, I think -- I know Professor
9 Bolton may disagree with this -- I think the law wisely
10 ignores that, because if you want to go into those lost
11 inframarginal revenues, you have to have a profit
12 maximization test, you know, what would have been the
13 profit-maximizing outcome of the strategy, and that is
14 in most cases going to be virtually impossible it seems
15 to me for the Court to figure out and surely impossible
16 for the firm to figure out in real time when it's trying
17 to comply with the law.
18 As implied by my discussion a minute ago with
19 the recoupment test, it's not going to correlate with
20 the welfare trade-offs you are looking at, although it
21 may illuminate a little bit, but most important, it
22 seems to me, is that price cuts on the inframarginal
23 purchases, price cuts until they are below some measure
24 of cost for the incremental units, enhance welfare, and
25 they enhance efficiency, and we all know that story,

1 right, going toward the competitive outcome, and you
2 reduce dead weight loss.
3 So, it seems to me that we ought to ignore
4 inframarginal revenues. I didn't mention this earlier,
5 I meant to say it, but costs ought to include
6 opportunity costs, ought to include the cost of moving
7 allocating assets to the predatory scheme rather than
8 somewhere else. That's part of the avoidable cost it
9 seems to me.
10 Forgoing inframarginal revenues in my view
11 shouldn't be treated as an opportunity cost, at least
12 not for this purpose, because they are not a cost. They
13 don't involve the consumption of any resources. They
14 are simply a transfer payment actually from producer to
15 consumer, and I don't see why we should take that into
16 account in the calculation.
17 Okay, so what does all this come down to? It
18 comes down to, I think, predatory pricing law ought to
19 be looked at in a common sense way. Predatory pricing
20 law ought to be looked at straightforwardly as pricing
21 that is not efficient, that is to say, pricing whose
22 avoidable costs exceeds the revenues generated by the
23 sales in question, and thus, pricing that reduces
24 welfare during the rivalry period.
25 If it's efficient pricing, if it increases

1 rivalry during the welfare period, the competitive
2 period, because consumers value the marginal units, or
3 the compliments that they generate, more than the
4 avoidable costs of those units, it seems to me we ought
5 to call this competition on the merits, and it ought to
6 be lawful.
7 Now, looked at this way, it seems to me,
8 predatory pricing isn't all that special. If we think
9 of it in this common sense way and simply ask where the
10 conduct is efficient in this sense, we have both in my
11 view a sound approach to predatory pricing and the
12 beginning of a more general theory of exclusionary
13 conduct that can avoid the pitfalls of the stovepipe
14 analysis to predatory pricing.
15 MR. POTTER: Thank you, Doug.
16 (Applause.)
17 MR. POTTER: Before we begin our round table
18 discussion, we will take a short maybe ten-minute break
19 to let people use the facilities and stretch, and if
20 they have to call their offices, call their offices.
21 MS. SCHULTHEISS: And coffee upstairs if they
22 need it, 7th floor, if you need coffee or water.
23 (A brief recess was taken.)
24 MR. POTTER: In deciding how to handle the round
25 table discussion, I thought maybe one of the effective

1 ways of doing this would be to put up various
2 propositions on the screen and then ask for agreement or
3 disagreement among the panelists. If there's agreement,
4 fine, we have reached a consensus point, we can go on,
5 and we have solved the issue, and if there is
6 disagreement, we can debate the issue. The panelists
7 all have this in front of them, so they do not have to
8 turn around and look at the screen every three seconds.
9 Do you want to put the first one up?
10 MR. POTTER: I think Professor Bolton already
11 indicated there might be convergence around this point,
12 but there used to be economic literature saying that
13 predatory pricing was an irrational business strategy.
14 The proposition for the consideration of the panelists
15 is that predatory pricing can be a rational business
16 strategy. Is there anyone on the panel who disagrees
17 with this?
18 DR. ELZINGA: There is no disagreement. I would
19 like to correct one matter for the record, at least I
20 think this is a correction. Patrick indicated that his
21 reading of John McGee's classic article on predatory
22 pricing in the Standard Oil case or the lack thereof
23 indicated that predatory pricing was always irrational.
24 I think that's unfair to Professor McGee. That is not
25 my exegesis of the article.

1 I think the position of McGee and the Chicago
2 School generally is that predatory pricing can be a
3 rational business strategy, it's just it's a very
4 unusual one, defined where it's successful, where it
5 works.
6 DR. ORDOVER: Well, I certainly agree with the
7 statement, with a couple of -- I don't know how many
8 caveats, but first -- five caveats -- one, two, three --
9 the first caveat is we have got to define what predation
10 means. Second, we have to figure out what the price is.
11 Third, we have got to figure out how to engage
12 rationality. Other than that, I think it's all fine.
13 Other than that, how was the performance, right? So,
14 this is exactly the way I see it.
15 I mean, this is surely a statement that has a
16 meaning as long as we can agree on the meaning of the
17 terms or words that go into the statement. None of
18 these things are relatively or clearly defined. We
19 already have different standards for predation. In the
20 airline case that Ken and I are in, pricing to whom is
21 an issue that -- average price on the aircraft? Is it
22 the price to the business passengers, the leisure
23 passengers? A huge amount of disagreement. Is it the
24 price of the incremental unit? Is the price averaged
25 out over the volume that is being sold?

1 Anyway, what's rational? I guess
2 profit-maximizing, over what horizon, what discount
3 rates we are going to use? All of these things enter
4 into what we have been struggling with, which is to say
5 that we have something -- we understand a basic core set
6 of issues, but I think these remaining areas of
7 disagreement are really needed to breathe light --
8 MR. POTTER: And with the later slides, we will
9 get into those specific areas.
10 DR. ORDOVER: I haven't looked at them. Ex ante
11 assessment, huh?
12 MR. MELAMED: Just a comment provoked by what
13 Janusz said, there is always -- at least in my
14 experience in cases I have dealt with, I am not involved
15 in Spirit -- difficult questions about what are the
16 products you're talking about, what prices are you
17 talking about, is it the leisure passengers or whoever
18 it may be. There is, if there is discipline in the
19 overall case, however, some discipline on the parties on
20 that issue, if the plaintiff wants to argue that the
21 price is predatory because he found one passenger in
22 seat 14B where the price was below cost, he is probably
23 not going to be able to prove that he was driven out of
24 the market on account of the predatory price, and so if
25 the courts are rigorous in connecting the allegedly

1 predatory activity with the requirement of proving a
2 causal connection with the creation or maintenance of
3 market power, some of the sort intellectual concerns
4 that Janusz has may become less practically important.
5 DR. ORDOVER: Actually, it was 15C that's at
6 issue.
7 MR. POTTER: Patrick?
8 DR. BOLTON: So, you know, I may well have read
9 too much into McGee's article. Having said that, I
10 think it does -- the legacy that's left is tremendous
11 skepticism, and what I wanted to say was that there has
12 been new scholarship started in the 1980s, rigorous
13 economic scholarship based on rigorous game theory
14 analysis showing exactly how predatory pricing strategy
15 could be rational, and I think what I want to say is
16 that where things have changed is that slowly, this
17 literature is being brought in, is being acknowledged,
18 and is being recognized, and so what I wanted to say is
19 that, if anything, today, we should be less skeptical
20 about the rationale for predatory pricing than we have
21 been and that the Supreme Court has been in its Brooke
22 decision and its Matsushita decision, which was based on
23 older writing which couldn't be articulated using the
24 tools of the modern game theory.
25 MR. POTTER: Okay, subject to Janusz's caveats,

1 I will take that as agreement among the panel.
2 The second proposition, this is a quote from the
3 Supreme Court in 1986, two decades old now. "Predatory
4 pricing is 'rarely tried, and even more rarely
5 successful,'" was repeated in Brooke Group in '93. Does
6 the panel think that this is still a correct statement?
7 Doug?
8 MR. MELAMED: Well, I don't know. I will leave
9 it to the economists. The question is whether it means
10 anything. You know, murder may be rare, too, in some
11 statistical sense.
12 But I wanted to say something about that,
13 because I think in my own thinking, at least, until
14 yesterday when I was preparing for this, there was some
15 sloppiness, and maybe that's true of others, as well.
16 In Matsushita, interestingly, when I looked at it, that
17 was when the proposition was first set, it was used as a
18 factual proposition to aid the Court's assessment of the
19 evidence and to say is the predatory theory here
20 sufficiently plausible that we should let it go to the
21 jury?
22 It morphed into something else by the time of
23 Brooke Group. It morphed into the rationale for
24 defining predation a particular way. If it's used that
25 way, we have to be very careful about what we mean. If

1 we mean pricing below cost is rarely tried and even more
2 rarely successful, it's rationally then used in
3 Matsushita, but it doesn't support Brooke Group, because
4 that would be like saying killing with an ice pick is
5 very rare, so let's define murder as consisting solely
6 of killing with an ice pick.
7 The question, if you want to justify or explore
8 the wisdom of defining predatory pricing as pricing
9 below cost, the question is, what about the conduct that
10 isn't deemed to be predatory pricing by that definition,
11 some kind of profit sacrifice at above cost levels, is
12 that rarely tried and rarely successful? And I'm just
13 not sure that there has been rigor in thinking about
14 what this statement means.
15 MR. POTTER: Building off of this slide, does
16 anybody have a view on whether predatory pricing is more
17 or less likely in certain industries because of the
18 characteristics of those industries?
19 DR. ELZINGA: Yes, I certainly do. I have a
20 belief that predatory pricing is more likely to occur
21 where the target firm will exit quickly and be unlike --
22 either the target firm or other capacity will be
23 unlikely to enter again, and just picking up on
24 something that Doug said, where you are trying to look
25 for some more simple benchmark, he suggested just

1 focusing on where avoidable costs exceed the revenues of
2 the practice, well, that's a very helpful way of
3 thinking about predation.
4 I think it's just as powerful, maybe even more
5 illuminating, to focus on entry and exit conditions as a
6 kind of filter, and I am a little surprised that Doug
7 never mentioned focusing on exit and entry. That is
8 kind of the mirror image of what he is getting at, but I
9 think it is clearer and analytically more robust.
10 MR. POTTER: Janusz?
11 DR. ORDOVER: Well, I think certainly by the
12 basic principle of self-selection, you at least observe
13 an attempt to induce an exit in the industry in which
14 exit is likely to be relatively quick or not too
15 costly -- it will be not too costly to engage in such a
16 strategy and in which, as Bobby and I said, re-entry is
17 very difficult entry or re-entry is very difficult. If
18 re-entry is trivial, as it generally could be in the
19 airline industry, setting aside the question of
20 signaling predation, setting aside gate constraints and
21 those kind of things -- which were not present in
22 Detroit, just by the way.
23 I think that obviously nobody in his right mind
24 is going to try to exit somebody who has invested
25 hundreds of millions of dollars of sunk capital that is

1 simply impossible to take out, but you can try very
2 aggressively and actively to prevent that person from
3 putting in another hundred million dollars of to-be-sunk
4 capital. So, you can try to accomplish something
5 different, but actually self-selection and rational
6 business behavior that we have all accepted as a premise
7 of what firms do, such as that you are not going to try
8 it when it is not likely to be successful, which is why
9 when we get to the recoupment phase of this whole thing,
10 we will probably have different views from what the
11 slides will ask us to say, but it is all part and parcel
12 of the same aspect of the analysis, which is to say, you
13 have to look at the entry and re-entry barriers and the
14 exit barriers or problems with trying to dislodge the
15 rival or problems with the ability to increase the entry
16 or impediment facing the incumbent. If you cannot
17 accomplish entry-enhancing creation of a barrier, then
18 you are not likely to go after that, because somebody is
19 going to come back sooner or later. How soon is
20 unpredictable.
21 DR. BOLTON: I have very little to add, just two
22 remarks. There used to be a time when economists
23 characterized the airline industry as a contestable
24 market. I just want to remark that we have come a long
25 way from that conclusion. Now we are I think defining

1 the airline industry as particularly prone to predatory
2 pricing.
3 And on the rarely tried and even more rarely
4 successful, I want to be even more outrageous by saying
5 that, you know, nuclear bombs have been rarely tried,
6 but they have been very successful. We have to look at
7 the deterrent effect of episodic, very rare predatory
8 pricing. So, you know, you look back at predatory
9 pricing in the telecom industry at the beginning of the
10 century or in the tobacco industry, it was followed by
11 prolonged periods of lack of entry and oligopolistic
12 pricing with very high returns to the firms, which is
13 evidence that consumers were not getting the low prices
14 that they deserved.
15 MR. POTTER: Proposition three, because lower
16 prices immediately benefit consumers, we should be
17 extremely careful not to adopt legal rules that can
18 result in false positives; that is, condemn legitimate
19 price-cutting. This seems to be a fundamental basis of
20 Brooke Group, at least. Anybody have any agreement or
21 disagreement with this? First say agreement.
22 DR. ELZINGA: Agreement certainly for me.
23 DR. BOLTON: I beg to disagree on the following
24 grounds, not in principle, but on the basis of the
25 evidence. How concerned should we be about false

1 positives today after a quarter century of systematic
2 rejection of predatory pricing allegations? How worried
3 should we be today that firms will be very cautious in
4 their pricing and will refrain from aggressive pricing
5 after this record?
6 I think in principle, we should be worried about
7 this, but I am not sure that with the past history of
8 predatory pricing enforcement that this is still a major
9 concern.
10 MR. POTTER: Ken, I think you wanted to comment.
11 DR. ELZINGA: Yes, let me comment at two
12 different levels.
13 First of all, there is no doubt, since
14 Matsushita, that the economists have taught us things
15 that we did not know at the time about models in which
16 predatory pricing can be successful for the predator
17 under conditions of certain financial asymmetries or
18 information asymmetries or information effects, but if
19 you look at some of the cases, the most recent, I think,
20 or if I'm mistaken, the most recent predatory pricing
21 case brought by the FTC, a long time ago, was the coffee
22 case, General Foods Coffee case, and the staff was
23 unsuccessful on that.
24 When we look at the record, did Maxwell House,
25 which had all the things that would fit nicely into this

1 model of reputation effects, signaling and so on, where
2 you might think, boy, this looks like predatory pricing,
3 the way the game theorists would structure the world,
4 and people like Milgrom and Roberts have referred to
5 that case as illustrative of applying their models to
6 predatory pricing.
7 Well, that was a case in which Maxwell House was
8 trying to keep Folgers from moving east. They were
9 singularly unsuccessful. Folgers rolled out nationally,
10 and if you walk around a bit, you just don't see Maxwell
11 House of having visual evidence of being a monopolist in
12 the coffee industry today. You are much more apt to see
13 Starbucks than Maxwell House.
14 Matsushita, you think about the signaling
15 effects or the reputation effects that the Japanese had
16 and the popular culture at that time about being
17 price-aggressive. You look at the television industry
18 today -- now remember, this is a case the Japanese
19 won -- they have less than 40 percent of the television
20 business, total, all the companies combined. The
21 largest television producer in the world is in China.
22 Brooke Group, the idea there was the majors, led
23 by Brown & Williamson, would dial down the discount
24 segment. That was a term used over and over again in
25 Brooke Group. The discount segment would be dialed

1 down. Everybody would be left buying a full revenue
2 cigarette if they were a smoker.
3 The discount segment continues to grow. It's
4 about 40 percent of the industry now. So, if all of
5 these cases had been decided differently using game
6 theoretic approach or a concern that Patrick expresses,
7 I think consumers would be worse off. I really do.
8 MR. POTTER: Janusz?
9 DR. ORDOVER: One comment. I think that there
10 is an issue that we may want to talk about a little bit
11 more, and that is to say, the rigor and the reviews of
12 the galaxy of predation models that are based on really
13 state-of-the-art game theory, and the question, what
14 follows from those in terms of public policy? To me,
15 that is the biggest problem that I have been totally
16 incapable of resolving in my own head, but in the end,
17 coming down on the proposition that while we cannot be
18 as perhaps lackadaisical about anticompetitive
19 exclusionary behavior as the Court in this famous quote
20 was, we still need to take some kind of tools that the
21 courts can use to say, yes, yes, I agree, things can
22 happen, and Milgrom and Roberts and Kreps-Wilson, they
23 all have shown all those things, and many others follow
24 and, you know, your lovely paper with Scharfstein on --
25 what, signal jamming or -- it was, signal jamming paper,

1 which was the coffee case, and all those things are all
2 true.
3 And then we come back to the question, what to
4 do with that, how to translate it into something that a
5 businessperson, who has to be counseled, will be able to
6 understand in day-to-day operations, and how will the
7 Court be able to take these principles of game theory,
8 subgame perfect, Nash equilibria and all these things,
9 and translate it into some simple rules that, you know,
10 thou shall not do what? Thou shall not signal that you
11 are going to be a tough guy? You can't say that. You
12 have to be able to translate it into something. "Look,
13 you can write any memos you want, you can do anything
14 you want, but you cannot do X."
15 I think that it is absolutely essential that we
16 take these models and we translate them into principles
17 that are implementable by the business people, by the
18 lawyers and by the courts. Otherwise, we are nowhere,
19 and I think what we have been struggling with is trying
20 to come to articulation of some principles that are
21 actually understandable, and I think Doug went a long
22 way in proposing that we actually take the learning of
23 these models as implying we should not dismiss these
24 cases, but we should take the learning of these models
25 and figure out what they mean in terms of implementable

1 rules by all the stakeholders, and that includes, of
2 course, consumers as well.
3 MR. POTTER: Doug, in your dealings with your
4 clients, without a rule that is under-inclusive by
5 protecting against false positives, is it your belief
6 that monopolists wouldn't price close to the line?
7 MR. MELAMED: Ah, I'm not sure I understood the
8 question. I think you are asking, should we worry about
9 over-deterrence?
10 MR. POTTER: Well, if we don't protect against
11 false positives, will the chilling effect of getting too
12 close to the line lead people with monopoly power not to
13 lower their prices to consumers because they're worried
14 about false liability?
15 MR. MELAMED: Sometimes. I do not know whether
16 the overall economy, with the relative magnitude, what
17 its effects are. I particularly agree with how Janusz
18 started. The signals you send to the business community
19 are much more important frankly than whether the cases
20 are right or wrong. If every case at the margin were
21 wrongly decided but we were generally setting a useful
22 set of standards, the law would be pretty good. So, the
23 question is the false positives versus the false
24 negatives.
25 Generally speaking, with the state of the law

1 today, you have a slide later on, is it hard to counsel
2 your client? No, I say not to worry about it, because
3 the -- but actually -- actually --
4 DR. ORDOVER: Can we go home now?
5 MR. MELAMED: But actually, I say more than
6 that. First I say you may lose the characterization
7 issue, you may not be able to prove predatory pricing,
8 but then I say, "Wait a minute, there are certain
9 settings in which you could get hurt. Is your target
10 likely not only to withdraw from this market but, for
11 example, to go out of business and become bankrupt and
12 his only asset may be a lawsuit? How litigious is he?
13 Is this a part of some broader commercial strategy?"
14 So, there are situations I think even with the
15 law today totally in favor of the weight of false
16 positives where it probably does deter some
17 procompetitive pricing. Whether on balance at this rule
18 or at some other rule that harm is greater than the harm
19 of false negatives I'll leave to the economists.
20 MR. POTTER: All right.
21 Next one, establishing a reasonable prospect of
22 recoupment should be essential in any analysis of
23 predatory pricing. Is there anyone who disagrees with
24 this statement?
25 MR. MELAMED: Only to the extent I already said

1 so.

2 MR. POTTER: Janusz?

3 DR. ORDOVER: Oh, I think the point I want to
4 make is that from my perspective, this recoupment
5 component is really part and parcel of a prior filter.
6 Now, you can try to do it at the later stage. My
7 preference is to ask the question whether the particular
8 markets, market or markets, in which this
9 anticompetitive conduct is alleged to be exclusionary,
10 anti-consumer, whatever characterizations you want to
11 attach, is acceptable to incremental exercise of market
12 power, and if the answer is no because, you know, you
13 get rid of this particular rival, but, you know, quick
14 as a bunny, somebody else is going to show up who may be
15 even more competitively advantaged rival, then there is
16 no need to somehow construct this potentially
17 complicated analytics.

18 As is clear from Ken Elzinga's net present value
19 calculation, it is a very, very difficult step, possibly
20 as difficult as the step of measuring revenues to costs,
21 which costs which revenues and so on and so forth. So,
22 I would say that as a filter, you certainly would want
23 to implement a step during which the parties will slug
24 it out, one saying, "Look, I get rid of you, there is
25 ten more coming. I get rid of you, that will carry no

1 visible signal for the rest of the players that may be
2 sitting out on the outskirts and waiting what to do."
3 Or it could be that the firm which you are
4 trying to induce to exit or to restrain its expansion is
5 what I called in the first slide a scarce competitor,
6 and, in fact, there is something very special, very
7 particular about that rival which cannot be replicated,
8 and in that case, yes, you get to the point in which the
9 assessment of this later recoupment or the implications
10 of this strategy is critical, and if you cannot show --
11 you, the plaintiff -- that if you exit the marketplace
12 or if you get cut back in the marketplace, economic
13 welfare is going to be hurt in some way, then I think
14 you have gone very far in challenging the conduct at
15 issue.
16 MR. POTTER: Next slide -- oh, I'm sorry.
17 DR. ELZINGA: I was just going to say, I think I
18 am saying just the same thing that Janusz said but
19 perhaps in just a couple words. I do not think you need
20 to do a recoupment analysis for many predation
21 allegations, because entry conditions or prices and
22 costs will tell you you needn't take that extra step.
23 DR. BOLTON: Can I just add --
24 MR. POTTER: Sure, go ahead.
25 DR. BOLTON: -- one comment? So, I agree with

1 Janusz that in principle, recoupment is important, it is
2 the right question to ask, but in terms of how do you
3 administer a recoupment test, I think the weight has to
4 be on what you call the reasonable prospect, and I think
5 a narrow reading of a recoupment test, as you criticized
6 earlier, I would criticize as well.
7 MR. POTTER: Okay, fair enough.
8 Next slide. Prices above some measure of cost,
9 and you can all pick your own measure of cost that you
10 think is the best cost, whatever it is, should not be
11 considered predatory. Is there anyone who disagrees
12 with this?
13 Patrick, do you want to say anything?
14 DR. BOLTON: So, from the -- well, we know that
15 a policy of -- after Brooke Group is that a price -- at
16 least a price above average total cost should not be
17 considered as predatory. I am happy to live with that,
18 although I am not sure that it is always a wise policy.
19 MR. POTTER: When it is --
20 DR. BOLTON: I would disagree, though, with the
21 statement that prices above average variable cost should
22 not be considered as predatory.
23 MR. POTTER: You just mentioned that you might
24 disagree in certain instances that even prices above
25 average total cost should not be predatory.

1 DR. BOLTON: Could be predatory. In principle,
2 in theory, there are situations where prices above --
3 even price above total cost can be predatory.
4 MR. POTTER: Can you give an example of those?
5 DR. BOLTON: Well, an example of a large
6 incumbent with increasing returns, scaled technology,
7 facing a small entrant that has not been able to reach
8 minimum cost capacity, you could exclude that entrant by
9 pricing lower than monopoly price but still above your
10 average total cost and exclude the entrant.
11 DR. ORDOVER: Maybe I could just ask you a
12 question. Would you comment on the cost principles -- I
13 have been puzzled by them myself -- that follow from
14 these various game theory like models of, say,
15 Kreps-Wilson? They do not seem to give clear cost
16 benchmarks. Is that true? Is that your reading as
17 well?
18 DR. BOLTON: Yes, that is correct. They do not
19 give a clear reading on cost benchmarks, and I think
20 there is a whole group of economists who have been
21 working on predatory pricing who think that costs are a
22 very poor way of discriminating between anticompetitive
23 effects and procompetitive effects, that there are as
24 likely to be false positives as there are to be false
25 negatives. There are many situations where pricing is

1 below even average variable cost, and it is efficient.
2 It is not predatory. So, a lot of economists feel it is
3 just a poor test.
4 MR. POTTER: Doug?
5 MR. MELAMED: Let me ask Patrick this question.
6 I understand the theory, even if I cannot understand the
7 game theory, of why an above cost, even above total
8 cost, but below profit -- monopoly profit-maximizing
9 test could be predatory in the sense that it could
10 exclude a rival and in the long run we are all going to
11 be worse off for it.
12 What I don't understand and I am interested in
13 your reaction to is how one turns that into a legal rule
14 that companies can comply with. I mean, how do you --
15 you know, if -- sure, if you imagine -- if you posit a
16 stable market on day one and then the entrant comes and
17 maybe you have a good historic benchmark and you can
18 say, "Gee, he's changed his pricing," but even then you
19 have to ask the question, "Well, what would the monopoly
20 profit maximizing price be with the new entrant?" Is
21 each company supposed to hire a game theorist and work
22 out the game and figure out --
23 DR. ORDOVER: Yes.
24 MR. MELAMED: -- what the price is? In other
25 words, how do we implement that test?

1 MR. POTTER: Patrick is looking for future
2 employment.
3 DR. ORDOVER: We all are.
4 DR. BOLTON: Administerability is a serious
5 concern, I take that. I'm happy with a rule that
6 says -- I would not object to a rule that says price
7 above average total cost is per se legal as a way of
8 implementing an easily administrable rule.
9 As for determining whether it is procompetitive
10 or anticompetitive conduct, I think there -- while
11 business decisions are taken on average in a rational
12 way, and you have to get justifications for the kind of
13 policy you are implementing, these justifications often
14 find their form in written documents in the company,
15 whether it is emails or other board room records, and as
16 I emphasized in my presentation, this is evidence of
17 intent, which is extremely valuable. Intent here, that
18 kind of intent evidence, is a very good guide to the
19 kind of effects a policy can have, and there, I think we
20 can be on pretty firm ground, and we do not have to
21 do -- we do not have to hire a game theorist to do that
22 kind of analysis.
23 MR. MELAMED: Sometimes companies adapt to the
24 law, and if they are well counseled, they know how to
25 write pieces of paper that perhaps articulate an

1 economic rationale rather than intent.
2 DR. ELZINGA: And in like fashion, Doug, I
3 suspect you have encountered clients who just aren't
4 aware that when they write things, they have to be
5 written with an eye towards antitrust enforcement, and
6 so you do find documents coming -- to have militaristic
7 or powerful metaphors that have nothing to do with
8 consumer welfare and may, in fact, represent exaggerated
9 views of the company's prowess and stature in the
10 marketplace.
11 MR. MELAMED: I find almost invariably they are
12 written by lunatic middle managers, but --
13 MR. POTTER: That wasn't your position when you
14 were Deputy Assistant Attorney General.
15 MR. MELAMED: Well, you know, you learn.
16 DR. ORDOVER: Or those documents are usually by
17 investment bankers who are pedaling a particular deal or
18 something like that, alleging that as a result of action
19 X or Y, the firm would be able to leverage its market
20 power from one market to another. If one were to take
21 these arguments -- take these documents seriously, that
22 would be the end of most of the Chicago Business School,
23 presumably, investment banking, but also, the ability of
24 business people to compete in the marketplace, because
25 this is what these guys are selling. So, you have to

1 read their signal, which is the investment advice or
2 business advice which they proffer, as being an attempt
3 to market the product at above competitive price to the,
4 you know, willing or unwilling buyers, and I think that
5 that is why I am very worried about reading all kinds --
6 I mean, I have seen documents probably as good or as bad
7 as Doug or anyone, and I try to discount their value
8 because they are frequently misleading.
9 Now, this is not to say that people who run the
10 companies do not have an insight into the marketplaces
11 in which they are competing, but I think there are
12 limits of the kind of inferences you can really make
13 from those types of documents, especially when they are
14 also written by third parties with a very special agenda
15 of their own in my view.
16 MR. POTTER: Next slide, as long as we're on
17 costs, let's throw this out, a variety of cost tests.
18 The proposition for the panel is, average avoidable
19 cost, which for definition, cost per incremental unit
20 that does not have to be paid if the incremental units
21 are not produced, is the best cost measure to use if
22 forced to use the Brooke Group analysis. Is there any
23 disagreement with that?
24 Doug?
25 MR. MELAMED: Yes, I actually disagree with it

1 as phrased. I think it would be more useful to use
2 avoidable cost compared -- and then add up the revenues,
3 because when you say average avoidable cost compared to
4 price, you are limiting yourself to the revenues from
5 the product in question, and you can't take account by
6 that formula, at least, of two-sided markets and
7 everything else.
8 DR. ORDOVER: And networks. I think the issue,
9 just to pitch it to the folks if you want to raise it or
10 discuss it further, I think in the American Airlines
11 case, there was a lot of debate as to what the right
12 benchmark of cost was in my view, and at least the
13 Government had I think proposed four, if I am not
14 mistaken --
15 MR. POTTER: Correct.
16 DR. ORDOVER: -- that may be three too many,
17 but, you know, we have offered at least one or two
18 ourselves.
19 The same thing in Spirit, I think we have come
20 up with two different measures of cost, but they would
21 apply to different types of outputs, all passengers
22 rather than leisure versus business. So, there is a lot
23 of wiggle room as to what it is that this cost measure
24 is going to be applied to, and as Doug pointed out, it
25 is also key to figure out what is the measure of

1 revenues against which these costs are to be assessed.
2 So, I think that this is not a bad -- again,
3 this is not a bad standard, but I think it is important
4 to understand what is avoidability here that is at
5 stake.
6 For example, in the American Airlines case, we
7 thought, at least I thought quite strongly, that the
8 right set of costs would be those that if -- the airline
9 would avoid if it were to exit or substantially cut back
10 on a particular route, and that actually includes a lot
11 of costs that would be avoided, because it would include
12 avoiding the aircraft costs which were at issue, those
13 would be significant, much more than many other costs,
14 and it could be cutting back at the hub, perhaps,
15 cutting back at the stations from which the airline
16 would exit.
17 So, these avoidable costs which we looked at at
18 the route level are typically the kind of costs business
19 people look at when they make business decisions in the
20 airline business, and I thought there was a good measure
21 of avoidable cost. It happens so that the increment of
22 output over which we are looking at was that of the
23 route as opposed to -- it could be a seat or it could be
24 an aircraft or it could be a flight or something or an
25 aircraft day, because these aircraft, they fly in

1 strange ways around the globe, but there is all these
2 things that can be taken into account that could confuse
3 or could illuminate the matter.
4 MR. POTTER: I wanted to follow up on this slide
5 for a couple other questions. One, Doug, I think you
6 talked about this in your presentation, but I was
7 wondering if anybody had a view of whether opportunity
8 costs should be considered in viewing the cost test.
9 MR. MELAMED: Yes.
10 MR. POTTER: Doug, I thought you were a yes,
11 Doug. Does anybody else on the panel have any views on
12 that?
13 DR. ORDOVER: Well, as I said, I think in
14 American Airlines, we had an internal discussion of
15 what's the meaning -- what to do about the aircraft. I
16 mean, there is no denial that American Airlines brought
17 in additional flights. You could say, well, is there an
18 opportunity cost of that aircraft, and if there is, how
19 are you going to measure it? And one measure, which I
20 thought was the most easy to implement, would be to look
21 at the lease rates as opposed to trying to understand
22 what is another route that this aircraft could have been
23 flying or was this aircraft sitting somewhere in the
24 desert in Arizona and doing nothing? Maybe American has
25 a lot of aircraft like that, they could fly them at very

1 low incremental capital cost, but I thought that the
2 most reasonable assumption would be to assume that the
3 airline uses its aircraft properly and it could actually
4 deploy an aircraft by leasing a new one, which is why an
5 18-month time horizon I thought would reflect the
6 leasing strategies and the fact that heavy and costly
7 equipment was deployed, and there is no way of avoiding
8 counting the assets that are not being used, which
9 aircraft were one of them, and there are others that I
10 thought were appropriately included as well. That was
11 not the view necessarily of all of my colleagues on that
12 case.
13 MR. POTTER: Ken?
14 DR. ELZINGA: I do not think you could trust any
15 economist who would say opportunity costs should not be
16 considered. I mean, opportunity cost is the main
17 analytical construct that we bring to the social
18 sciences, that the cost of something is the highest
19 valued opportunity forgone, but the problem is that in
20 antitrust, opportunity cost is a Promethean expression,
21 and it is very difficult to unpack it, and one of the
22 sobering things for me, who has worked in this area for
23 a while and tried to think about it, is how fragile some
24 of the cases are, some of them that I have been involved
25 in, some of them that I have studied, to the taxonomy of

1 cost.

2 The case that Janusz and I were involved in,
3 what do you mean by the price of the product? Is it to
4 all passengers, or is it to a group of passengers who
5 are called leisure and price-sensitive and business and
6 insensitive to price? The case can pivot upon that
7 taxonomy.

8 In Brooke Group, after hundreds of hours of
9 thought, one of the things that distressed me is that
10 price above average variable cost pivoted upon -- it
11 could pivot upon how you counted layers of tobacco.
12 Tobacco is stored for years to age, and if you used a
13 LIFO method, it looks like it violated Areeda-Turner.
14 If you used LOFI, it looked like it was okay, and I
15 don't like living in a world where it pivots upon what
16 accounting standard you use.

17 One of the things economists supposedly also
18 bring to the table is to get people out of using
19 accounting data and to think in terms of opportunity
20 costs, but even trying to apply that standard is
21 problematic, and when you live in a world where there's
22 a predatory pricing allegation, you probably are in a
23 world where prices are close to costs, by whatever
24 measure, and so then you start to figure out, well, how
25 close and above or below, you inherently, if you are

1 going to use a cost-based standard, have to deal with
2 accounting data, but you try to always put it through
3 the filter of opportunity costs.
4 DR. ORDOVER: Just as an anecdote, in the
5 American Airlines case, I lived through like three days
6 of deposition and a number of questions related to the
7 question of how we treated these carts that people put
8 their luggage on when they pick it up at the station
9 that was going to be exited potentially, so I finally in
10 desperation said, "Look, if the whole goddamn case turns
11 on how we treat these carts, then the Government
12 shouldn't be bringing a case like that." There has to
13 be something more to it than that, right?
14 And I think somewhere -- I mean, tobacco is
15 probably more important to cigarettes than the carts are
16 to the airline, but again, this is really demonstrating
17 very well the kind of deep-level accounting issues and
18 cost treatment of issues that can go whichever way
19 somebody wants them to go, and therefore, to say that
20 something is average avoidable cost is, again, the same
21 thing. It is average, it is avoidable, it is a cost,
22 but other than that...
23 MR. POTTER: If you are going to require
24 opportunity costs to be considered, how does that differ
25 from requiring the defendant to maximize his profit?

1 Because one view of opportunity costs is he had an
2 opportunity to get more profit. How do you distinguish
3 the two, if at all?
4 Patrick?
5 DR. BOLTON: Yes, so, this is where Doug drew a
6 very clear line that you should not count lost revenues
7 and inframarginal sales as an opportunity cost. I would
8 say as a matter of theory, you should count that as an
9 opportunity cost. The real question is just one of
10 administerability.
11 The other point I would make in this respect is
12 that --
13 DR. ELZINGA: I am sorry, could you just explain
14 for the benefit of at least me why, why you would count
15 that, the inframarginal?
16 DR. BOLTON: Well, because the question we are
17 trying to answer is, what is driving the price
18 reduction? Is this a move by the incumbent that will
19 raise profits irrespective of its anticompetitive
20 effects or not? To be able to answer that question, we
21 need to understand the nature of the profit sacrifice,
22 the size of the profit sacrifice and what justifies it.
23 Is there an efficiency rationale or is there an
24 anticompetitive rationale? So, we cannot avoid it, and
25 that is what I was going to say with respect to

1 recoupment.
2 Recoupment is the right question to ask. When
3 you try and make a recoupment analysis, you are
4 comparing profit sacrifice and return on investment.
5 So, it is inescapable, you have to look at lost revenue
6 and inframarginal sales when you do your recoupment
7 analysis.
8 Now, if you do it for your recoupment analysis,
9 I don't see why we should not take that into account for
10 the cost test, but I will leave that for -- I think I
11 see that as a practical problem and not a conceptual
12 problem.
13 MR. POTTER: Doug, do you want any extra time or
14 not?
15 MR. MELAMED: Well, the woman who is
16 transcribing this said I spoke so fast that maybe my
17 words were not caught before, but I will assume she got
18 them.
19 MR. POTTER: Okay. What about, how do we
20 distinguish in situations the appropriate costs when --
21 essentially price discrimination or nonlinear pricing?
22 Does anybody have any views on that?
23 Doug? No, that is not on the slide.
24 MR. MELAMED: What are the avoidable costs?
25 MR. POTTER: Fine, let's go to the next slide.

1 Out-of-market reputation effects are so hard to
2 assess they should not be considered in an analysis, and
3 let me just give you another minute on this. I am
4 thinking of a scenario whereby -- let's take the airline
5 industry. An airline allegedly predates on, let's say,
6 Dallas-Wichita. The airline has a bunch of other
7 markets where it's in, and perhaps it's got monopoly
8 power in a number of those markets. Maybe it doesn't
9 know, maybe we don't know, who potential entrants will
10 be in those other markets, but when the management team
11 sits down to determine what they are going to do in
12 Wichita-Dallas, they sit there and say, "Well, let's
13 drive the guy out, because future people then won't
14 challenge us in our other markets." How does that, if
15 at all, get analyzed in determining recoupment?
16 Patrick?
17 DR. BOLTON: Yes. So, we elaborate on this
18 point in our article. So, reputation effects do come
19 into a recoupment analysis to the extent that reputation
20 effects may raise the barriers to re-entry into the
21 market, and they do raise them in the form of making
22 other competitors aware that should they enter this
23 market, the first thing they will be facing is a tough
24 price war.
25 How do you prove reputation effects? That is

1 the harder question. But I do not think that that is
2 necessarily insurmountable. Again, there can be
3 analysis by the incumbent suggesting that this is a
4 profitable strategy, that reputation effects work, that
5 if we drive out this rival in this market, we will
6 benefit because there will not be other rivals or we
7 will be slowing down the growth of this rival.
8 So, this analysis is recognized by the
9 incumbent. If you find circumstantial evidence
10 suggesting that financiers think in those terms, that
11 they will raise the cost of funding of a new entrant
12 because they recognize that the market that the new
13 entrant is about to enter is one where there have been
14 past price war episodes, then I think this is all
15 evidence that this is a problem.
16 MR. POTTER: Ken?
17 DR. ELZINGA: This is a very strange statement,
18 and it could be easily misunderstood, but we have to
19 remember that the case for new entry and the enthusiasm
20 that we often have in antitrust for new entry can be
21 exaggerated. New entrants can inefficiently use
22 society's scarce resources. There are lots of
23 businesses that have no business entering an industry
24 because they use the resources inefficiently, and one of
25 the good things that keeps inefficient entrants out is

1 the reputation of incumbent firms for being tough,
2 aggressive, low-cost competitors.
3 My concern -- and again, so much of the
4 difference, perhaps, between Patrick and myself is one
5 of administerability -- is once you start bringing in
6 reputation effects as a potential hammer for antitrust
7 plaintiffs, what is the consequence of that for all the
8 good things that reputations do of incumbent firms to
9 keep people, even for their own good, out of markets in
10 which they have no business competing because they will
11 not be efficient utilizers of society's scarce resources
12 in those settings?
13 DR. ORDOVER: I think that the reputation
14 effects are almost a cornerstone of the new game
15 theoretic model of anticompetitive behavior of the sort
16 that Patrick summarized in his talk and his paper, and
17 there is no question that firms act in ways that try to
18 convey signals to the outside world and to the inside
19 world, and I think I would agree with Ken, not going so
20 far as we should not find entrants to be all such great
21 participants -- I like entrants. I think they should --
22 you know, let them slug it out.
23 Let's not create a presumption that some of them
24 may be inefficient ones or some of them are efficient
25 ones. Who the hell knows? It is the crucible of the

1 marketplace that ultimately will determine that.
2 But my issue is, again, I guess where we agree
3 is administerability, and then to say, yes, indeed, it
4 is plausible to postulate the reputation effects. We
5 have the economic models. What we don't know in real
6 life is how many of these new entrants do you have to
7 kill in the airline business before somebody finally
8 realizes, hey, I'm not coming in, and empirical work
9 shows that no matter how many of them you squish, they
10 always come back, and so you say, am I still in the
11 reputation-building way or am I in the recoupment phase
12 or how am I going to account for that other than to say,
13 look, you go ahead and do what you want to do, compete
14 as hard as you want, but you should not break the
15 following simple rules, whatever they might be, because
16 I cannot account for all the other additional
17 considerations.
18 However, I think it is appropriate to say that
19 these reputational effects that we are encountering in
20 economic theoretical literature, but also in some
21 empirical stuff. In fact, there is some beautiful work
22 by Canadians on the supermarkets in Canada, indeed,
23 indicating that some reputational effects that have been
24 established. I just don't see how I can translate that
25 into an administrable test for the courts and for

1 counsel, because what can Doug say to somebody who says,
2 "Look, I think I want to kill three guys because I think
3 that will be enough," and he goes, "No, only kill two."
4 I mean, what? What do you say? I just don't know how
5 to do it. I wouldn't know how to do it.
6 MR. MELAMED: Look, if the client comes to me
7 and says, in effect, I want to cut my prices to below my
8 avoidable costs, I might say, "Why are you doing that?
9 You are going to run the risk of losing an antitrust
10 case." And if he says to me, "I'll beat the rap because
11 they will never hang me with the recoupment thing,"
12 because if my recoupment is going to be my reputation, I
13 might say, "That ought to be illegal."
14 That is to say, as Patrick says, if you can
15 prove a plausible recoupment story, a reputational
16 story, that, in fact, you are gaining market power
17 because you are gaining reputation and it is not just
18 the lawyers -- the plaintiff's lawyer's fantasy, then I
19 don't know why that's not enough to satisfy the market
20 power screen. In the Microsoft case, for example, which
21 I believe was rightly decided, the proof of competitive
22 effects was, you know, rather conjectural, but you had
23 conduct that unequivocally didn't do anybody any good
24 and you had a plausible theory of a market power entry
25 barrier story and the fact that Microsoft believed that.

1 Why wouldn't that be enough just because we have price
2 here as opposed to the set of conduct that was at issue
3 in Microsoft?
4 DR. ORDOVER: I think that there are substantial
5 sunk costs of coming in, combined with the signaling, I
6 think you have a plausible story to tell, say, look, you
7 know, you are trying to convince these people that if
8 they come in, there is going to be an aggressive price,
9 and with the substantial sunk costs at issue, that might
10 be something that will take you over the edge, and they
11 say, I'll stay out of the relevant market, but it is the
12 combination of the informational aspects of behavior
13 coupled with the structural features, which is
14 substantial up-front costs, which you require and that
15 the market power screen really -- to say, ah, this
16 market is susceptible to anticompetitive behavior, it's
17 susceptible to recoupment or to price elevation if you
18 protect it.
19 So, this acts as a part of the analytical story
20 that is being told, but again -- and I am perfectly
21 happy to accept it. What I am trying to say, it has to
22 go hand in hand with another aspect of the proof, which
23 is to say that the informational aspects are conjoined
24 with the real exposure that the entrants will face if
25 things go wrong, so that when he comes in, it loses a

1 lot of money if it stays, because it cannot exit, and
2 therefore, it is not willing to try. If exit and entry
3 are easy, then I don't believe there is much power to
4 that informational signal.
5 MR. MELAMED: I agree completely with that.
6 MR. POTTER: Next slide. I know at least one of
7 our panelists said in his presentation that he would
8 disagree with this, so, Patrick, I believe that is you,
9 but we will see what the others think. Meeting
10 competition should not be a defense to predatory
11 pricing. Is there anybody who agrees with that?
12 MR. MELAMED: Agrees that it should not be?
13 MR. POTTER: Should not be. Doug, one
14 agreement. Patrick, you disagree. Okay, Doug, why --
15 DR. ORDOVER: Wait, should not be --
16 MR. POTTER: Should not be a defense. So, you
17 have essentially a high-cost producer. A lower-cost
18 producer comes in, more efficient, at lower price. The
19 high-cost producer cuts his price, lowers cost to meet
20 competition. Should that be protected or not in a
21 predatory pricing case?
22 DR. BOLTON: So, on the meeting competition
23 defense, if meeting the competition is a best response,
24 then this should be a defense. So, in principle, this
25 is an admissible defense. Administerability, again,

1 concerns are important here. For example, what do we
2 mean by meeting the competition? Is matching the price
3 of the entrant meeting the competition? Is that how we
4 define it? I would argue that's dangerous, because the
5 products may not be the same. If the incumbent's
6 product is higher quality than the entrant's, then
7 matching the price of the entrant is not meeting
8 competition. It's --
9 MR. POTTER: So, a jury is going to decide what
10 the quality-adjusted price is?
11 DR. BOLTON: (Nodding.)
12 MR. POTTER: Doug?
13 MR. MELAMED: I think Patrick and I might not
14 actually disagree but just use different words. He said
15 if this is the best response. If it's the best
16 response, then it would seem to me that the revenues
17 generated by the response are in excess of the avoidable
18 costs, in which case it passes the price-cost test, but
19 if that's not the case, if it fails that test, it's an
20 inefficient response. The fact that he's meeting
21 competition I don't think should make it a safe harbor.
22 MR. POTTER: On a more general basis, it's not
23 one of the slides, but what role should efficiencies
24 play as a defense to predatory pricing? I know,
25 Patrick, you think they should play a central role. Any

1 of the other panelists have a view on that?
2 (No response.)
3 MR. POTTER: Seeing none, we will go on to the
4 next slide.
5 It is extremely difficult to craft an effective
6 injunctive remedy in predatory pricing cases, and I'm
7 thinking of the -- I think there was at least one TRO in
8 a case where the judge said for purposes of the TRO, the
9 company couldn't price above the price that it had set
10 on August 1st, you know --
11 DR. ORDOVER: Of any year?
12 MR. POTTER: Well, it was a particular year, you
13 know, subject to changes in raw material costs. You
14 know, is that the remedy that --
15 DR. ORDOVER: That was the Baumol Test, right,
16 you can cut the price, but you can't raise it for five
17 years?
18 MR. POTTER: What is the injunctive remedy? I
19 understand what the damage remedy is if it's a private
20 case. What is the effective injunctive remedy? Is
21 there any?
22 Doug, have you given that some thought?
23 MR. MELAMED: Yes, that question I have. I
24 think it is very difficult, very dicey. There may be a
25 circumstance in which it makes sense for a court to

1 specify a price in that sense, I can't offhand think of
2 one, but I don't know why it's a terrible thing to
3 simply say, "I declare the conduct to be illegal, and I
4 order you to stop pricing below avoidable costs."
5 DR. ORDOVER: Having first defined it.
6 MR. MELAMED: Right, of course, assuming the law
7 has been decided so that we know what that means,
8 because I think the action in the government case, for
9 example, is to help the law evolve into sensible
10 principles, and then the deterrent effect might be
11 served by the damages rather than having government
12 regulate through injunctions.
13 MR. POTTER: Ken?
14 DR. ELZINGA: Well, probably like everybody on
15 around the table and everybody on the other side of the
16 table, I'm suspicious of having antitrust become a price
17 regulatory regime. It may be that in a genuine
18 predatory pricing case, as the Court has the authority,
19 that you could get at some other part of the structure
20 of the market that allows the predatory pricing to be a
21 viable marketing strategy. Patrick gives the example in
22 his article, which I found persuasive, of the Intel
23 Communications, whether the Court would have the
24 authority to get at the regulatory issue that allows the
25 financial asymmetries and the resource asymmetries to

1 make the predation successful.
2 I don't know, and I'm picking this not to pick a
3 dispute with Janusz, but let's say for point of argument
4 that -- I genuinely mean that -- but let's say that gate
5 constraints are the one variable that might make
6 predation successful in the airline industry, and if you
7 can get away from gate restraints, then new entrants
8 could always come in and unravel any successful
9 predation scheme. I would much prefer in the setting
10 like that for a court to say, "Well, instead of trying
11 to monitor and manipulate prices of airline tickets to
12 make sure they're above some measure of cost, that we do
13 away with that particular structural constraint that
14 keeps the new entrant from being viable at such and such
15 an airport because they can't get gates."
16 If that were the case, perhaps that would be the
17 way to get at it. That would be more appealing to me
18 than having the Court monitor prices over time.
19 DR. ORDOVER: I cannot disagree on the gate
20 issues. It has been recognized in the airline business
21 that gates and slots are one of these assets that the
22 contestability literature perhaps forgot about when it
23 was first deployed in the airline business, capital and
24 wings, but I think that is a very sound prescription. I
25 just have, again, one little caveat.

1 One of the reasons these gate problems often
2 arise is because the airlines actually could finance a
3 large part of the construction of the airport, and that
4 becomes an issue, who is going to -- unless the airport
5 is a public resource that is not paid for by the
6 airlines or by one airline investing in a -- that's in a
7 part of the airport, if it's actually paying for these
8 gates, then I think it becomes potentially expropriation
9 of what could be a costly investment, and I think we
10 will have to worry about the remedy from the standpoint
11 of investment incentives, in other words, opening up the
12 scarce asset.
13 I don't have to worry about that so much perhaps
14 in the airline industry, but other industries.
15 Obviously Microsoft raised the question and said, "Wait
16 a minute, we are investing -- the remedy is to open up
17 the API. Hey, we are spending a huge amount of money
18 innovating in this space, and now you are telling me to
19 open up." So, this is again, you know, perhaps even
20 more problematic than regulating price, to regulate
21 access. It is an equally complex or even perhaps more
22 complex issue.
23 MR. POTTER: Let's go to the last slide, and we
24 are running a little bit out of time, but I definitely
25 wanted to get this question in and get a response from

1 each of the panelists.
2 The final slide is, if there was one thing you
3 could change with the current legal approach to
4 predatory pricing, what would it be? And since we
5 started with Ken, I think this time we will end with
6 Ken, in reverse order. Doug, why don't you take this
7 one first.
8 MR. MELAMED: I think I would just try to
9 demystify it a little bit and think of it simply as part
10 of a complicated set of strategies that companies use
11 that under some set of circumstances can be
12 anticompetitive.
13 MR. POTTER: Patrick?
14 DR. BOLTON: Yes, I would agree with that, and I
15 would also vote for de-emphasis of the cost test and
16 putting intent back as a possible way of proving
17 predatory pricing, and here, I think it would be helpful
18 to maybe articulate the guidelines on how one would --
19 what's a legitimate way of proving intent and perhaps,
20 you know, move in that direction.
21 MR. POTTER: Janusz?
22 DR. ORDOVER: I don't think I have a favorite.
23 I will just say that I will agree with Doug, that we
24 need to get clarity on what are the public policy or
25 economic principles that either underlie the tests that

1 are being proposed, where does the -- you know, the cost
2 tests, where do they come from? There has to be --
3 going back, I think at this point we have enough
4 learning to try to go back to first principles and try
5 to understand what it is that we are trying to
6 accomplish, taking full account of the administerability
7 of whatever provisions are going to ultimately be
8 developed, but I think it would be foolish for us -- for
9 me, anyway -- to vote for the least favorite aspect of
10 what is out there at this point.
11 MR. POTTER: Ken?
12 DR. ELZINGA: Well, I certainly can't argue
13 against Janusz's call for clarity, but I think we are in
14 a pretty congenial equilibrium right now.
15 MR. POTTER: Good. I just want to point out
16 that over on the side, we have some of this afternoon's
17 panelists that were kind enough to be here this morning.
18 They are John Kirkwood, Tim Brennan and Rick
19 Warren-Boulton, and just right before we leave, I will
20 give each of you 30 seconds to say anything you wanted
21 to say about this morning's panel, or if you just want
22 to wait until this afternoon, feel free. Anyone want to
23 take a go?
24 DR. WARREN-BOULTON: I think I will wait for
25 this afternoon, but --

1 MR. POTTER: You will all wait for this
2 afternoon?
3 Well, if you could join me in thanking the
4 panelists.
5 (Applause.)
6 MR. POTTER: That will end the morning session,
7 and the afternoon session begins at 1:30. Thank you
8 very much.
9 (Whereupon, at 11:56 a.m., a lunch recess was
10 taken.)
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1 AFTERNOON SESSION
2 (1:28 p.m.)
3 MS. SCHULTHEISS: Everybody ready? Okay, good
4 afternoon, and for those of you who were not here this
5 morning, my name is Pat Schultheiss. I'm an attorney
6 with the Federal Trade Commission's Bureau of
7 Competition in the Office of Policy and Coordination,
8 and I am the lead moderator for this afternoon. My
9 co-moderator is Bob Potter, who is the Chief of the
10 Legal Policy Section at the Federal -- at the Department
11 of Justice's Antitrust Division. I was going to put you
12 at the FTC again, sorry, Bob. I can't just get those
13 words out.
14 Before we start, a few housekeeping matters.
15 First, for everybody's benefit, please turn off your
16 cell phones, Blackberries, any other device that might
17 make noise during the session. We appreciate that.
18 Second, the restrooms are out to -- men's room
19 right to the left, and the women's room, past the
20 elevators and to your left. There are little signs out
21 there to guide you as well.
22 Third, in the very rare event that the alarms
23 happen to go off, please just calmly proceed down the
24 staircase and follow the zillion FTC attorneys and staff
25 that will be going towards 7th Street to the Sculpture

1 Garden. Those are the preliminaries.
2 This afternoon's topic is dealing with predatory
3 pricing but looking at it from the buying or bidding
4 side. We have assembled a very distinguished panel who
5 will discuss I think, among other things, just how
6 common buy-side predatory pricing is in the real world,
7 if at all, whether it's common at all, what Section 2 of
8 the Sherman Act can and should be doing about predatory
9 buying or bidding, and I'm sure there will be many other
10 things. I know we will have a little bit of raising
11 rivals' costs from Professor Salop and others. So, with
12 that, let me introduce very briefly the panel, and then
13 I will introduce with a little bit of greater detail
14 each panelist right before they speak.
15 Our panelists this afternoon, in the order they
16 will be speaking, are Professor Jack Kirkwood from the
17 University of Seattle; Professor Tim Brennan from the
18 University of Maryland, Baltimore County; Professor
19 Steve Salop from Georgetown University; Rick
20 Warren-Boulton, a consultant with Microeconomic
21 Consulting and Research Associates; and Janet McDavid, a
22 partner with Hogan & Hartson. Each of the panelists
23 will give a 10 to 15-minute presentation. After that,
24 we will take a brief break and then have a panel
25 discussion for the remainder of our time. I would like

1 to thank all the panelists for being here and for the
2 morning panelists who have decided to stay and enjoy the
3 rest of the discussion. We greatly appreciate the
4 willingness of all of the panelists to give their time,
5 not just here today, but also the time input into
6 preparing for this session.
7 Our first speaker today is going to be Jack
8 Kirkwood, as I said. Jack is a professor of law at the
9 Seattle University School of Law. Before joining the
10 Seattle University, Professor Kirkwood was an attorney
11 with the Federal Trade Commission. Before leaving the
12 rarified air of Washington, D.C., he was the director of
13 several policy offices here in the Premerger
14 Notification Program, but then decided to head out to
15 the Pacific Northwest, and he joined the Seattle
16 Regional Office, where he headed up numerous antitrust
17 investigations and cases.
18 Professor Kirkwood has edited two books and
19 published numerous articles, and he recently addressed
20 the topic of today's hearing in his article in the
21 Antitrust Law Journal, "Buyer Power and Exclusionary
22 Conduct: Should Brooke Group Set the Standards For
23 Buyer-Induced Price Discrimination and Predatory
24 Bidding?"
25 In addition, Jack Kirkwood is a consultant for

1 the plaintiffs in the Weyerhaeuser appeal against
2 Ross-Simmons in the Ninth Circuit. I think we only have
3 one panelist who is not somehow or another involved in
4 the Weyerhaeuser case, but with that, Jack.
5 MR. KIRKWOOD: Thanks, Pat, and thank you to
6 both agencies for inviting me.
7 This panel's focus is especially significant.
8 It's not only an intellectual or antitrust policy
9 question, but it is a question of how should the Supreme
10 Court come out in a case that in my sense is they are
11 very likely to take, Ross-Simmons versus Weyerhaeuser,
12 and the central issue in that case, of course, will be
13 should Brooke Group apply. Should Brooke Group's
14 price-cost and recoupment tests apply to a practice that
15 has been called predatory overbuying or predatory
16 bidding.
17 This is, as I've conceived it and as Steve and
18 others have looked at it, is in major respects the
19 mirror image of predatory pricing on the sell-side.
20 With predatory bidding, a dominant buyer bids up the
21 price of a critical input, forcing up the market price,
22 and in certain circumstances, making it impossible for
23 rival buyers to continue to compete, causing either
24 their exit or their inability to constrain the dominant
25 buyer's future exercise of power, and hence, the

1 dominant buyer captures monopsony power that it wouldn't
2 otherwise have, and in some circumstances, this may lead
3 to a long-run harm to welfare, most directly to supplier
4 welfare but also possibly to consumer welfare as well.
5 Given these similarities, all of the Supreme
6 Court's stated rationales for applying Brooke Group
7 apply to predatory bidding as well, at least to some
8 degree. Furthermore, the only alternative test approved
9 by the Ninth Circuit was an exceptionally vague jury
10 instruction allowing the jury to find liability if it
11 found that Weyerhaeuser bid more than "necessary" in
12 order to prevent the plaintiff from buying at a "fair
13 price." That strikes me as too vague and many others as
14 well.
15 So, if that test is not acceptable, should we
16 resort to Brooke Group or try something in the middle?
17 And what I am going to suggest today is that a
18 middle-of-the-road test is more appropriate, a test that
19 has two parts. One, the plaintiff would have to show
20 harm to welfare, I will explain what that means, but the
21 defendant would get a complete defense if it can show
22 that it would pass the no-economic-sense test.
23 Why a middle-of-the-road test, why not Brooke
24 Group? In some significant respects, predatory bidding
25 is different from predatory pricing. There is, of

1 course, one cosmetic difference. In predatory bidding,
2 the first thing that happens is input prices go up,
3 output prices to consumers do not go down, at least
4 initially. So, there is this key difference in terms of
5 what we normally think of as the central focus of
6 antitrust on providing low prices to consumers, but that
7 is essentially a cosmetic rather than an important
8 difference, because when a buyer bids up input prices
9 that benefit suppliers, it can be procompetitive, and
10 through an output effect I will describe, it can benefit
11 consumers as well. So, we should be concerned with
12 chilling procompetitive bidding for inputs just as we
13 are concerned about chilling procompetitive price cuts.
14 There is, though, a more significant difference.
15 Compared to predatory pricing cases, predatory bidding
16 cases have been brought less frequently, have been won
17 less frequently, and arguably, there have been no false
18 positives, no liability findings where it appeared that
19 the defendant had not, indeed, harmed welfare. That is
20 arguable, not hardly proven.
21 In the last two decades, since the mid-eighties,
22 there have only been two cases in which the plaintiffs
23 have won. Both have involved bidding up timber prices
24 in the Pacific Northwest, and if the Supreme Court takes
25 Weyerhaeuser, we are not even sure that the plaintiff

1 will have won the second case. Why is it that these
2 cases seem to be rarer and that the proportion of
3 successful predation may be higher? Rick Warren-Boulton
4 will address that. I will defer to him on that. I have
5 suggestions, but he can cover it.
6 This track record suggests to me, at least, that
7 it is a little too early to apply a Brooke Group
8 price-cost safe harbor test to predatory bidding. To be
9 sure, the number of successful cases is too small to
10 produce a reliable conclusion that predatory bidding is
11 more dangerous than predatory pricing to welfare. We
12 are not there yet, yet the track record does suggest
13 that the danger of deterring procompetitive bidding is
14 less high than it is with predatory pricing, at least if
15 there were a stiff rule that applied to a plaintiff as I
16 will suggest.
17 This is consistent with my experience at the FTC
18 as head of the Planning Office, the Evaluation Office,
19 and then as a staff attorney in Seattle. I received
20 over the years many complaints about price-cutting but
21 never, ever, a complaint about bidding up input prices.
22 There are two other reasons to think we ought at
23 this point to choose a more flexible test rather than a
24 Brooke Group safe harbor. One is, there has been to
25 date much less scholarly or judicial analysis of the

1 practice, though thanks to the agencies and thanks to
2 Steve, we are working on that. Even so, even so, the
3 pile of articles on predatory bidding does not compare
4 to the mountain on predatory pricing.
5 There is also a growing, though probably still
6 minority, view that the Brooke Group average variable
7 cost test, at least as interpreted that way, may not be
8 the right standard even for predatory pricing where the
9 concern with chilling procompetitive price competition
10 is greater; that at least it counsels against extended
11 Brooke Group predatory bidding.
12 What would an alternative test look like? My
13 suggestion, just a proposal, is to put a stiff burden on
14 the plaintiff and to give the defendant a complete
15 defense. The plaintiff's burden would be to show harm
16 to welfare. So, a plaintiff would have to prove the
17 elements of a welfare-reducing instance of predatory
18 bidding. So, they would have to show that, yes, the
19 price was bid up; yes, at least some significant rivals
20 were constrained in their ability to hold up, since we
21 are talking about bidding, hold up the alleged
22 predator's price; as a result, the predator got
23 monopsony power it would not otherwise have; and most
24 important of all, the plaintiff would have to show that
25 the long-run impact on welfare was negative. So, to

1 pick up on one of Ken's key points this morning, the
2 plaintiff would have to show that it was relatively easy
3 to induce exit, but either re-entry or new entry would
4 be more difficult.
5 How should we measure welfare? I have
6 deliberately not put an adjective in front of it. It
7 seems to me there are two principal possibilities: One,
8 supplier welfare; two, consumer welfare. Steve is going
9 to talk about either of those measures, particularly
10 consumer welfare as opposed to total welfare. I will
11 skip that debate.
12 Between supplier welfare and consumer welfare,
13 it seems that both precedent and ease of measurement
14 favor supplier welfare. The cases that have looked at
15 monopsony abuses and at buyer cartels tend, on balance,
16 to focus on the impact on suppliers rather than on
17 consumers.
18 In addition, there can be instances of
19 substantial harm with little or no measurable effect on
20 consumers. So, if the plaintiff had to show some sort
21 of significant, discernible, provable effect on
22 consumers, that would be harder. So, I am tending to
23 favor a supplier welfare test, but you could use a
24 consumer welfare test at least for most cases. Why is
25 that? Because successful monopsonization is likely to

1 harm consumers in two ways.
2 One, as many economists have pointed out, if the
3 predatory bidding produces a net increase in long-run
4 monopsony power, then there is likely to be a reduction
5 in output. The dominant buyer is likely, on balance,
6 over time, to buy less, and if it buys less, it is
7 likely to produce less, and that means there is likely
8 to be less final product on the market. And so, if the
9 demand curve is neither totally vertical nor totally
10 horizontal, if it is the normal downward sloping type,
11 then less output is going to put some upward pressure on
12 price.
13 So, the mere output effect will tend to harm
14 consumers, again, maybe not noticeably, but there is
15 that linkage, and that does not require market power.
16 That is, the dominant buyer does not have to have market
17 power in the final product market for this effect to
18 occur. It occurs through the output reduction caused by
19 the monopsonization.
20 There could be, though, a market power effect,
21 as Rick may emphasize in his talk. Suppose the relevant
22 market downstream was limited to the product whose input
23 price was bid up. Then, if the dominant buyer
24 eliminates its key rivals as buyers, it will also
25 eliminate them as sellers. So, it may gain both

1 monopsony power upstream and monopoly power downstream,
2 and so then that would magnify the potential consumer
3 effect.
4 We could, therefore, use a consumer welfare
5 test, as Steve may suggest. There might have to be
6 exceptions, though, from such a test where predatory
7 bidding leads to monopsonization but consumers are
8 unaffected.
9 Whatever criterion is used for welfare, it seems
10 to me that a welfare test would provide substantial
11 protection to defendants. First, successful
12 monopsonization appears to be rare and appears to be
13 limited to certain markets, as Rick will suggest,
14 markets where there is inelastic supply, and that is not
15 commonly observed, typically in labor or natural
16 resource markets.
17 The power buyers that we all know or suspect,
18 the Wal-Marts, the Barnes & Nobles, the Costcos, they
19 don't induce lower prices by monopsonization. That is,
20 they do not go to their suppliers and say, "I am going
21 to cut back my output a little bit, and I expect,
22 because that will reduce your marginal cost, that you
23 will give me a lower price." Rather, they engage in
24 bargaining tactics, and at the risk of oversimplifying,
25 the way they obtain a lower price is, in essence, saying

1 that I am going to increase my purchases over what they
2 would otherwise be if and only if you give me a lower
3 price. So, that is not monopsonization.
4 So, one, you have the limited set of cases, and
5 two, you have all of those elements that the plaintiff
6 has to prove. I will not repeat them again, but showing
7 net long run harm to welfare is not an easy task. This
8 is essentially a full rule of reason analysis, and as
9 you well know, private plaintiffs do not often prevail
10 in full rule of reason cases. That has been the record
11 under Section 1 and is likely to be the record under
12 Section 2 as well.
13 You might say, "Ah, but private plaintiffs
14 prevailed in LePage's and below in Weyerhaeuser," but
15 the difference is in neither of those cases did the
16 courts insist on a full rule of reason net welfare test.
17 Is such a test unworkable? It is certainly
18 reasonable to contend it is, but we do use it in
19 horizontal merger cases under Section 7 and in full rule
20 of reason cases under Section 1, and as Steve has
21 pointed out, we are not really balancing immeasurables
22 when we use this long-run welfare test. We are not
23 trying to decide what's more important, national
24 security or freedom of speech. We are asking whether
25 the long-run impact on our target group, let's say

1 suppliers, is positive or negative.
2 Still, still, the inquiry would not be easy for
3 a defendant to predict its outcome, and the inquiry
4 would stretch over a longer time period than in the case
5 of a Section 7 matter certainly and probably the typical
6 Section 1 matter, because we are talking about a
7 long-run impact on welfare, and the key issue there, as
8 Ken has stressed this morning, is entry barriers, and
9 that is an uncertain and controversial topic. So, my
10 sense is that we should not rely solely on a welfare
11 test, that we should create an efficiency defense for
12 the defendant, and for that, I have borrowed from the
13 no-economic-sense test advocated by the Division.
14 It seems to me that if the defendant can show
15 that bidding up input prices was profitable, without
16 regard to any increase in monopsony power, that it
17 should have a complete defense. This would put the
18 burden on the party that best knows its own
19 profitability and would give it an out if it could
20 provide a good answer to the question, why did you do
21 this?
22 So, to conclude, let me give you just a simple
23 example. Suppose, as is my understanding of
24 Weyerhaeuser's theory, suppose the dominant buyer
25 improved its production process, lowering its marginal

1 cost. Then the new profit-maximizing price, without
2 regard to monopsony power, might be an increase in
3 output. That would entail buying more input, selling
4 more of the final product, so there would be a margin
5 reduction from paying more for the input and getting a
6 little less for the final product, but if the lower
7 marginal cost more than compensated for that, without
8 figuring in any increase in margin due to monopsony
9 power, then the defendant would be excused.
10 I am happy to talk more about that, but my time
11 is up.
12 MS. SCHULTHEISS: Thank you, Jack.
13 Our next speaker is Tim Brennan, who is, as I
14 indicated, a Professor of Public Policy and Economics at
15 the University of Maryland, Baltimore County. Professor
16 Brennan also has been serving as the 2006 T.D. MacDonald
17 Chair in Industrial Economics at the Canadian
18 Competition Bureau.
19 Before joining the University of Maryland,
20 Professor Brennan held a number of positions focusing on
21 economics and antitrust, including staff economist at
22 the Antitrust Division, senior economist for industrial
23 organization and regulatory policy on the staff of the
24 White House Council of Economic Advisers, and a
25 consultant to the Bureau of Economics here at the

1 Federal Trade Commission.
2 Professor Brennan's research areas related to
3 antitrust include regulatory economics, monopolization
4 law, exclusionary conduct, vertical integration, and the
5 competition-regulation interface. His articles have
6 appeared in numerous journals in economics, law, and
7 other fields.
8 Tim, would you care to start?
9 DR. BRENNAN: Thank you.
10 I am grateful to the Department of Justice and
11 to the FTC for the invitation to participate on this
12 predatory buying panel. It is a great honor for me to
13 be here. I am especially grateful because I have been
14 thinking for longer than I care to remember about how to
15 support Section 2 of the Sherman Act, and yet reconcile
16 it with less controversial, more accepted frameworks for
17 prosecuting cartels and horizontal mergers.
18 I will offer a suggestion along those lines
19 today. Although I believe that my suggestion will make
20 deserving exclusion cases easier to bring, some aspects
21 may be significantly different from established
22 jurisprudence. For that reason, I particularly
23 recognize the privilege of having a place at this
24 distinguished table.
25 Before proceeding, I need to say my statement

1 today reflects solely my own opinions and does not
2 represent those of the Competition Bureau or any of its
3 staff.
4 For this complex topic, I offer a series of
5 recommendations.
6 Predation or exclusion? Pick one or the
7 other -- they are fundamentally different.
8 When first asked to participate in a panel on
9 "predatory buying," my response was to object to the
10 title. We should recognize that "monopolization"
11 entails two essentially different types of practices,
12 one that for shorthand could be called "predation," and
13 the other "exclusion." The most succinct distinction is
14 that predation cases involve doing too much of a good
15 thing to bring about a bad result later. There, the
16 understandable concern is with deterring energetic
17 competition -- not discouraging firms from charging low
18 prices, adding product features, and the like.
19 Exclusion cases, on the other hand, involve
20 doing a bad thing now. One way or another they come
21 down to acquiring control and effective market power
22 over a supplier or access to an input or service needed
23 to compete, what economists called complements. The
24 most explicit way to accomplish such control would be
25 through a series of exclusive contracts with the

1 complement's suppliers. It may involve overbuying
2 inputs through explicit purchase or, as I'll suggest
3 below, bundling, rebates, or other forms of "leaving
4 money on the table." I call this practice "complement
5 market monopolization," or CMM.
6 The major problem with single-firm conduct law
7 is the failure to recognize the essential difference
8 between these two types of conduct, leading to the
9 counterproductive imposition of predation standards on
10 exclusion cases. Perhaps the failure arises from a
11 presumption that one statute -- Section 2 -- must imply
12 one principle. Perhaps it follows from the persistent
13 belief that Section 2 must be premised on harm to
14 rivals. Since competition also harms rivals, Section 2
15 law is thus driven by fear of over-deterrence. Instead,
16 exclusion cases should be recognized as different, where
17 we can apply horizontal tools and not predation screens
18 to the delineation and protection of complement markets.
19 Two, genuine predatory buying cases will be
20 rare; when they occur, validate necessary assumptions.
21 I would have changed the title of this panel to
22 "Exclusionary Buying," because the leading cases involve
23 creating of market power over complements. The recent
24 DOJ/FTC cert petition in Weyerhaeuser v. Ross-Simmons
25 illustrates an exception that proves the rule. The

1 exception is unusual, in that the concern is not that a
2 timber processor would acquire so much control over a
3 relevant market in uncut trees to be able to raise their
4 effective price. Rather, according to the petition, the
5 allegation is that a mill would pay too much for trees
6 to drive out other buyers, with subsequent recoupment by
7 cutting prices paid for trees in the future.
8 I have little to say about which market power,
9 price-to-cost, and recoupment tests are appropriate for
10 preventing over-deterrence in these rare predatory
11 buying cases. I do suggest that courts demand not only
12 evidence appropriate for such tests. They should also
13 demand evidence that specific assumptions behind
14 strategic models are satisfied, i.e., that the alleged
15 predator either has a reputation for non-profit
16 maximizing behavior to protect, or benefits from
17 identified asymmetric failures in capital markets.
18 Theoretical possibility alone does not make a practice
19 harmful.
20 Three, for exclusion cases, the first and
21 crucial step is to delineate a complement market being
22 monopolized using the Horizontal Merger Guidelines
23 procedures.
24 Market power is often characterized not just as
25 the ability to raise price but also as "the ability to

1 exclude." This is a mistake of imprecision. Ability to
2 raise the price of X depends upon entry barriers or
3 other impediments to competition, but those do not
4 depend upon the price of X. Higher X prices would, if
5 anything, encourage entry. Rather, the ability to
6 exclude depends upon control over the prices of Y, Z, W,
7 or something else needed to enter and produce X.
8 Delineation of that relevant complement market
9 should therefore be the first step in all exclusion
10 cases. Taking Dentsply as an example, the case rested
11 on the premise that the national distributors constitute
12 what in merger contexts we would regard as a relevant
13 market, in this case for the distribution of teeth to
14 dental labs. The Merger Guidelines provide the useful
15 framework for testing this premise. They ask whether
16 teeth manufacturers would turn to other distributors,
17 whether there would be entry into that distribution
18 market in response to a "small but significant
19 nontransitory increase in price" of using such dealers.
20 I do not know the facts of that case and thus
21 the answers, but the Merger Guidelines ask exactly the
22 right questions. Cases eventually turn to evidence of
23 entry or substitution into the complement market, but
24 they do not make such concerns central -- the best
25 indicator being the continued identification of a

1 relevant market as that in which the alleged monopolizer
2 is already dominant, not that over inputs or services
3 competitors need to compete. Control over such a
4 complement market is not only sufficient to raise
5 competitive concerns; it is necessary for
6 anticompetitive exclusion.
7 Hence, plaintiffs should focus on identifying
8 that complement market and showing that the practices at
9 hand cover enough of it to raise the complement's price.
10 In effect, one should ask if one would be troubled if
11 the complement providers covered by the alleged
12 exclusionary practice merged. Unlike usual
13 characterizations of monopolization cases, this is one
14 we know how to answer -- use the Merger Guidelines. If
15 the answer is no, stop; if the answer is yes, go to the
16 next step.
17 Next, having delineated the relevant complement
18 market, the second step should be to establish the price
19 effect in that market.
20 Barriers to entry cannot be raised, and
21 competition impeded, by any more than the extent to
22 which the price of the complement can be raised.
23 Sometimes this higher price will be explicit, sometimes
24 it will be only an inferred higher price -- Professor
25 Carlton has usefully called it a "shadow price" -- if

1 the exclusionary practice so ties up the complement
2 market that only higher priced substitutes, including
3 self-provision, are available.
4 Explicit exclusive dealing contracts offer one
5 such standard: Firms wanting to use those dealers would
6 have to cover the cost of breaching the contract. Other
7 alleged exclusionary practices, such as bundle discounts
8 or royalty rebates, may create a significant price
9 increase -- once one has established the first step.
10 Next, the standard for assessing the
11 exclusionary effect of a bundle or rebate is not whether
12 an incremental price is below incremental cost, but its
13 effect on the price of the complement.
14 Following the last point, one could ask whether
15 bundles, rebates, or other programs have to increase the
16 effective price of the complement as much as it would
17 explicit contracts. I have no reason to believe it
18 should. Were we to follow the Merger Guidelines, as we
19 should for complement market definition, we might only
20 need ask if the practice leads to a small but
21 significant nontransitory increase in price of the
22 complement.
23 This tells us that whether a bundle is
24 anticompetitive has nothing to do with a predation-like
25 test. It does not depend on whether the incremental

1 price of adding a good to a bundle, or of supplying more
2 of a product given a discount, is less than some measure
3 of marginal or average variable cost. Rather, it
4 depends only on the extent to which such practices
5 create market power in order to raise the price others
6 must pay for the services provided by retailers,
7 distributors, or other complement providers getting the
8 discount.
9 Predation case screens -- profit sacrifice,
10 equally efficient competitor, and prior dominance -- do
11 not belong in exclusion cases.
12 Even for predation, we have heard today, some
13 commentators have noted that some or all of the screens
14 need not increase competition and consumer benefit.
15 Nevertheless, they may be appropriate to prevent
16 over-deterrence of competition through low prices or
17 added features. However, in exclusion cases,
18 controlling a monopoly share of complement markets is
19 not inherently procompetitive, and thus need not have
20 high bars for its protection.
21 The profit sacrifice or "no business sense"
22 test -- the two are equivalent if one assumes that
23 "business sense" means "maximize profits" -- substitutes
24 concern with intent and tactics for concern with
25 effects, as if whether someone had been murdered depends

1 upon the price paid for the gun. Others have noted that
2 it creates an absolute efficiencies defense, in that a
3 penny of gain from a practice excuses untold
4 anticompetitive harms. As Rick Warren-Boulton has said,
5 the test is notably inappropriate when regulated
6 monopolists do the excluding.
7 Although I have criticized "raising rivals'
8 costs," mostly for its emphasis on "rivals," Steve
9 deserves enormous credit for pointing out long ago that
10 predatory sacrifice and recoupment is unnecessary to
11 point out the tactics that raise those costs. My
12 difference is that I would focus primarily on the
13 complement market.
14 Ironically, the test also forgets that once upon
15 a time, profit sacrifice implied previously unobserved
16 efficiency, not anticompetitive harm. We learned that
17 exclusive territories, exclusive dealing, tying, and
18 even resale price maintenance must generate efficiencies
19 because they reduce demand, making even monopolists
20 worse off otherwise. That realization gradually
21 reformed most vertical restraint law. Assuming now that
22 a profit sacrifice must be anticompetitive forgets
23 antitrust history and invites us to repeat mistakes that
24 have not been fully undone after nearly a century.
25 On equally efficient competitors, I point out

1 what should be obvious: Inefficient competitors hold
2 down price. Complement market monopolization leading to
3 their exclusion can raise price and harm consumers.
4 Having gone after two sacred cows, I may as well
5 finish off the herd: The Grinnell prior possession of
6 monopoly test can also impede meritorious exclusion
7 cases. It distracts attention away from the complement
8 market, focusing instead on the characteristics of who
9 monopolized it. Prior dominance could even be a
10 defense, but once complement market monopolization is
11 shown, it should be up to a defendant to claim that it
12 has no consequence because of monopoly elsewhere in the
13 production chain.
14 Moreover, this test is counterproductive.
15 Proving the cost, demand, and entry barriers necessary
16 to establish prior dominance undercuts the argument that
17 the alleged exclusionary practice makes a difference.
18 Using Richard Posner's phrase, the monopoly should be
19 "fragile" at worst. An exclusion case will be strongest
20 if the sector would be competitive, but for the practice
21 under scrutiny.
22 Ask whether we would apply these standards to
23 mergers. Should all mergers be legal unless one could
24 show they would be unprofitable but for anticompetitive
25 harm? Should any merger, including to monopoly, be

1 legal if a more efficient firm buys and eliminates a
2 less efficient competitor? Of course not. Even prior
3 dominance may make the incremental effect of a merger
4 less troubling. If these tests would gut merger law,
5 and if exclusion cases are akin to acquisitions in the
6 complement market, they do not belong on this side of
7 Section 2.
8 Consider share-based rather than "all or
9 nothing" remedies.
10 Analogy to mergers opens the door to more
11 creative remedies. Generally, either a practice is
12 okay, or it is not and should be stopped. We should
13 instead take a share-based approach. Exclusive dealing
14 contracts, bundles, or other alleged monopolizing
15 practices might have efficiency benefits. The problem
16 is not the practices per se, but their scale -- that
17 they pre-empt so much of the complement market to raise
18 its price significantly. Rather, defendants should be
19 allowed to retain the practice, but only over a
20 nondominant share of the complement market, 35 percent,
21 50 percent or some appropriate number. If the practice
22 is actually efficient, it will be kept. If it serves
23 only to exclude, this remedy would lead to its
24 discontinuance.
25 Last, focus on the creation of monopolies, not

1 their maintenance.
2 About two years ago, I gave a talk at the FTC on
3 these ideas, entitled "Saving Section 2." As I began,
4 an economist there asked, "Why should anyone want to
5 save Section 2?" My answer may not have satisfied him,
6 but in short, it is that it can and should be saved.
7 Were all Section 2, single-firm conduct cases about
8 protecting a monopolist's rivals by drawing vague or
9 impossible lines between competing just enough and too
10 much, I might have agreed with the questioner. However,
11 exclusion cases are not about maintaining monopolies but
12 creating new ones. In focusing on complement market
13 monopolization, such cases can and should be no more
14 controversial than collusion and merger cases are today.
15 Thank you again for the privilege of allowing me
16 to share these observations. I hope I can clarify them
17 through responses to any questions you have here and as
18 they arise in the future. Thanks very much.
19 (Applause.)
20 MS. SCHULTHEISS: Our next speaker will be Steve
21 Salop, who is a Professor of Economics and Law at the
22 Georgetown University Law Center where Steve teaches
23 courses in antitrust law and economics and economic
24 reasoning for lawyers. Dr. Salop also has a consulting
25 practice at CRA International involving a variety of

1 antitrust issues.
2 Before joining the Georgetown faculty, Steve
3 held positions at the Federal Trade Commission, and a
4 while back, the Civil Aeronautics Board and the Federal
5 Reserve Board. Professor Salop has written numerous
6 articles in various areas of antitrust economics and
7 law, many of which take a, quote unquote, "post-Chicago"
8 approach. Professor Salop recently published two
9 articles in the Antitrust Law Journal that concern
10 exclusionary behavior and monopoly power.
11 Of particular importance for today's hearing is
12 his article, "Anticompetitive Overbuying By Power
13 Buyers." It contrasts predatory versus raising rivals'
14 costs, overbuying behavior, and I will let him go
15 further into that.
16 And in addition, Professor Salop has also
17 consulted for Weyerhaeuser in its appeal and district
18 court decision. Is that correct?
19 DR. SALOP: Yes, that's correct.
20 MS. SCHULTHEISS: So, with that, I will hand it
21 over to you.
22 DR. SALOP: Okay, thank you.
23 I want to talk about these two types of
24 overbuying, predatory overbuying, what Jack called
25 predatory bidding, and raising rivals' costs overbuying,

1 but to just set it up, I think a key place to begin is a
2 notion that Tim Brennan touched on, the fact that in
3 Section 2, there are really two distinct paradigms, and
4 I believe that the way individual people think about
5 Section 2 has a lot to do with which paradigm they have
6 in mind, you know, which one animates them, and so I
7 want to stress the difference between these two
8 paradigms.
9 One paradigm is the predatory pricing paradigm,
10 seller-side predatory pricing, and the other is the
11 raising rivals' costs or non-price predation paradigm.
12 Now, in my view, and a key element in what I am going to
13 talk about today, and, indeed, much of my work, is that
14 conduct that fits into the raising rivals' cost paradigm
15 raises much greater concerns than conduct that fits
16 within or that people characterize as the predatory
17 pricing paradigm.
18 Now, we all know the claims about why predatory
19 pricing is seldom attempted and rarely succeeds. In the
20 short run, the predator loses more money than the
21 victim. Secondly, it only works if the victim exits.
22 Otherwise, there is no -- they will never be able to
23 recoup. And third, consumers benefit from the lower
24 prices, and the harm to consumers is mere speculative
25 impact in the future. So, for all those reasons, it is

1 argued that predatory pricing is unlikely to be tried,
2 it is unlikely to succeed, and it is unlikely to harm
3 consumers, and therefore, we should have a really light
4 hand in predatory pricing.
5 Taken as a paradigm, conduct that raises rivals'
6 costs raises much greater antitrust concerns; hence,
7 let's say it is more likely to succeed, more likely to
8 harm consumers. Why? Well, first, there is no need to
9 induce competitors to exit. If you raise competitors'
10 costs, variable costs, they will tend to raise price,
11 and the excluding firm will gain even if the competitors
12 do not exit. You would rather compete against a
13 high-cost competitor than a low-cost competitor.
14 Secondly, there is no necessity for short-run
15 profit sacrifice, chronological profit sacrifice, of the
16 sort there is in predatory pricing. If the rivals'
17 costs are increased, they will raise price immediately.
18 The predator, the excluding firm, will gain immediately.
19 So, there is no issue that the predator has to lose
20 money for a while and then only gain later.
21 Similarly, there is no short-run consumer
22 benefit, and this one I think is very important. In
23 predatory pricing, the consumers inevitably benefit from
24 that lower price in the short run. In raising rivals'
25 costs, there is no inherent consumer benefit. You raise

1 rivals' costs, they raise price or contract, and the
2 defendant raises price, so consumers are harmed
3 immediately. There is no such thing as naked predatory
4 pricing, you know, just all bad, the way there is with
5 naked price-fixing, but there is naked raising rivals'
6 costs. One could conceive of that burning down the
7 factory, so on and so forth, and such conduct that
8 actually shows up in certain cases.
9 So, for all those reasons, I think that you have
10 these two paradigms that are distinct, and I think most
11 of the time you should be thinking in terms of the
12 raising rivals' costs paradigm. I think it is a better
13 paradigm for Section 2. I think that the predatory
14 pricing is the exceptional paradigm, not the norm.
15 Well, now let's apply this to anticompetitive
16 overbuying. Now, there are -- by overbuying, I mean
17 conduct where the defendant goes into the input market
18 and bids up the price of the input. Usually if you bid
19 up the price of the input, you are generally almost
20 surely going to buy more than you would have otherwise.
21 So, it is often called overbuying. Indeed, in the
22 literature, it was initially referred to as overbuying
23 cases, and I guess sort of the classic case that
24 economists studied initially was the bauxite aspect of
25 the Alcoa case, where Alcoa was alleged to have

1 overbought bauxite in order to raise the costs to its
2 aluminum rivals.
3 Well, there are two distinct overbuying
4 allegations that correspond analytically to the two
5 exclusion paradigms. There is predatory overbuying,
6 Jack talked about, and then there is raising rivals'
7 costs overbuying, and the difference between these two
8 paradigms is the goal of predatory bidding or predatory
9 overbuying is to gain monopsony power to the input
10 market, as Jack pointed out. The goal of raising
11 rivals' costs overbuying is to raise your rivals' costs
12 and then gain market power in the downstream output
13 market.
14 Okay, so if you think about Alcoa, they could
15 have overbought bauxite for -- one reason would be to
16 ultimately knock out the other purchasers of bauxite so
17 it could then be a bauxite monopsonist, and the
18 alternative would be that they did it in order to raise
19 the price of bauxite to its rivals so that they could
20 ultimately monopolize, raise the price, of aluminum. Of
21 course, in a given case, you could have both, but at the
22 same time, in a case, you could have one or the other.
23 Now, interestingly, in the Weyerhaeuser case and
24 the Ross-Simmons case, both allegations were made in the
25 complaint. It was alleged that Weyerhaeuser, by its

1 conduct, would ultimately gain monopsony power in the
2 timber market, in the purchase of timber, and secondly,
3 it was argued that Ross-Simmons would gain market power
4 in a downstream alder wood, alder hardwood market, and
5 Ross-Simmons did not carry its burden on the raising
6 rivals' costs piece, and so the part that has gone up is
7 just the predatory overbuying piece.
8 Okay, well, how do I think we should evaluate
9 these two types of conduct? I want to separate them.
10 So, first, the predatory overbuying, as I said, it's
11 market power in the upstream market that's the goal, and
12 in general, I have in mind a four-step legal standard,
13 very close, very, very close, to what Jack Kirkwood
14 called for, and I will talk about it and then stress the
15 differences.
16 So, the four steps would be, you have got to
17 show buyer power, monopsony power, and artificially
18 inflated input purchasing, and it's really the latter,
19 you have to show that they bought more and that the
20 price went up. You have to show exit or permanent
21 capacity reduction of the input market competitors, that
22 should be, and then there has got to be some kind of
23 recoupment through buyer-side monopsony power in the
24 input market, and finally, and this is very important,
25 you have to show net consumer harm.

1 Now, usually in these cases there will be a
2 short-run consumer benefit during the predatory period,
3 because when the defendant buys more of the input, it
4 will produce more output, and so the price of output
5 will go down, and then during a recoupment period, it
6 goes in the other direction, so consumers benefit in the
7 short run, harmed in the long run, and for that reason,
8 in order to show -- in order to gain -- show liability,
9 the plaintiff would have to show consumer harm on
10 balance.
11 Okay, now, let me go through the steps in a
12 little more detail. First of all, note, Jack Kirkwood
13 said, well, I'm not sure you need consumer harm, maybe
14 it's enough to have supplier harm, so that is one
15 difference between our standards to date. Jack actually
16 in his article had this last step, consumer harm. So,
17 he has broadened his position today.
18 Now, the first step, the issue here is the
19 question is, is the increased purchasing artificial or
20 is it competitively driven? Now, you know, there are a
21 lot of good reasons why a firm may increase its input
22 purchases in this year versus last year. For example,
23 maybe the demand for its output went up. It needs more
24 inputs to produce more output. Maybe it is not so much
25 its demand went up, maybe it decided to change its

1 business strategy. Maybe it decided to decide to grow
2 its market share rather than go for a high price in the
3 output market. Or maybe it got a new production process
4 that is more efficient, and that leads it to want more
5 inputs in order to expand. Fourth, maybe something
6 happened in the input market. It used to have monopsony
7 power, and it finds it has lost that monopsony power or
8 has less of it, and so it wants to stop acting like a
9 monopsonist.
10 All four of those reasons would lead it to
11 increase its demand for inputs. As its demand for
12 inputs goes up, the price of the inputs would tend to
13 rise, and its purchases would tend to rise. So, for
14 these reasons, I mean, what would be most suspicious
15 would be if the defendant bought extra inputs and then
16 did not use them, just warehoused them, all right,
17 because that would suggest it was not buying more in
18 order to produce more output, but rather, did it in
19 order to raise price and drive its rivals out of
20 business. So, warehousing would be an issue.
21 Of course, the fact that it has inventories does
22 not necessarily mean it is warehousing. It could have
23 been an error. It could have just bought more thinking
24 it was going to need it and then it just did not need
25 it. So, one has to be careful there.

1 Because of the concern, you know, that there are
2 all these legitimate reasons why you might want to
3 purchase more output, and the fact that there is this
4 inherent short-run consumer benefit, I am very worried
5 that there could be false positives, and for that
6 reason, I am willing to put on the Brooke Group style
7 test of output priced below cost, where it's really sort
8 of that marginal revenue product, or Rick went on to the
9 value of marginal product, being less than the input
10 price. Because here, like with predatory pricing, there
11 is inherent consumer benefit in the short run that may
12 or may not be offset by consumer harm in the long run,
13 and because there is that balance, it is a lot like
14 predatory pricing, and so the rule might be close to the
15 predatory pricing rule.
16 I also think that in the end, this is why the
17 Supreme Court will opt for a Brooke Group kind of test,
18 because it is so close to the reasoning in Brooke Group
19 that they are going to probably find it irresistible to
20 change the rule.
21 Now, it is possible that there is no consumer
22 benefit in the short run. If the demand for the output
23 was perfectly elastic, demand for the input was
24 perfectly elastic, in terms of price taker, then, when
25 it increases its purchases, it will not reduce the price

1 that consumers pay for the outputs. There would be no
2 consumer benefit. But on the other hand, and under
3 those same circumstances, there would not be any
4 consumer harm. So, under those circumstances, the
5 plaintiff would lose anyway. So, I think the Brooke
6 Group, adding the price-cost test in Brooke Group, will
7 not cause any damage in this situation.
8 Now, when it comes to raising rivals' costs
9 overbuying, I feel a more interventional stance is
10 necessary. Again, I have got a four-step legal
11 standard. I do not have the Brooke Group piece, and, of
12 course, the analysis is somewhat different, because the
13 goal here is to gain market power in the downstream
14 market, not to gain market power in the upstream market.
15 So, you would still ask whether there were good reasons
16 for the firm to increase its demand for the input, but I
17 would not go so far as the Brooke Group test.
18 Here, you not only have warehousing could be a
19 concern, but also naked purchasing. Now, what I mean by
20 naked purchasing is suppose the firm does not even use
21 the input. It might buy up some of the input for the
22 sole purpose of making it more expensive for its rivals.
23 For example, in the Alcoa case, it was alleged that
24 Alcoa bought exclusive contracts to electricity from
25 utilities where it never had a plan. They just bought

1 the exclusive so that other aluminum companies could not
2 buy electricity in those regions. So, that would be an
3 example of naked buying, there where an exclusive wasn't
4 overbuying, it was simply buying the exclusive.
5 You would never have naked overbuying for
6 predatory overbuying, because you can't get a
7 monopsony -- why would you want a monopsony? Why would
8 you want to knock rivals out and get a monopsony over
9 some input that you don't even use? So, you know, it
10 just does not compute.
11 So, assuming that you can show inflated input
12 purchasing, then you go through the standard type of
13 raising rivals' costs analysis to show consumer harm.
14 You have to show that rivals' costs were raised
15 materially, but that's not enough. That's just harm to
16 competitors. We know in Section 2 that is not enough.
17 You also have to show harm to competition, as you have
18 to show downstream market power, some power over price
19 downstream. And then, as before, you need to show net
20 consumer harm, because the overpurchasing could have
21 efficiency benefits. Maybe the firm is producing more
22 output and, you know, competing harder, that is a
23 benefit. So, you want to have that consumer harm
24 standard. As I said, it is more interventionist.
25 Now, by consumer harm, I really mean it. I mean

1 true consumer harm. I do not mean supplier welfare, and
2 I do not mean what Robert Bork called the consumer
3 welfare standard, which was really a total welfare
4 standard. I think Bork was either deceiving people,
5 which is what Herb Hovenkamp has said, or maybe Bork was
6 just confused, and the reason I think it is possible he
7 was confused is that if you care about the total welfare
8 standard, then competitor injury is enough to carry the
9 day, because competitors are part of total welfare.
10 Indeed, it is easy to construct mainstream
11 simple examples in which conduct could harm competitors,
12 consumers could benefit with lower prices, but yet total
13 welfare could fall, and yet under the total welfare
14 standard, total welfare would go down, and so if you had
15 in mind a total welfare standard, that conduct would be
16 illegal. Now, I just cannot believe that Bork would
17 want to make such conduct illegal. So, I have chosen to
18 believe, out of respect, that he was confused rather
19 than attempting to create a consumer protection problem
20 or a court protection problem.
21 There are other reasons why I think the consumer
22 welfare standard is better. It is consistent with
23 precedent. It is what the agencies use. It is simple
24 to evaluate. Actually, the analysis I have done and
25 several other economists have done, it has shown that

1 actually, even if you care about total welfare, for
2 several reasons, the consumer welfare standard actually
3 could lead to higher total welfare, and I will go into
4 that if that comes up later on.
5 Finally, I think the consumer welfare standard
6 supports innovation better than does the total welfare
7 standard. Again, I will go into that if there is time
8 later on.
9 So, thank you very much.
10 (Applause.)
11 MS. SCHULTHEISS: Okay, our next speaker is
12 Dr. Rick Warren-Boulton, a principal of MiCRA,
13 Microeconomic Consulting and Research Associates, an
14 economics consulting firm and research firm specializing
15 in antitrust litigation and regulatory matters. Before
16 joining MiCRA --
17 DR. WARREN-BOULTON: We like to call that
18 "MiCRA."
19 MS. SCHULTHEISS: I like to call it "MiCRA."
20 Rick Warren-Boulton served in a number of positions
21 involving economics and antitrust law. He was an
22 Associate Professor of Economics at Washington
23 University in St. Louis. He was the Chief Economist for
24 the Antitrust Division at the Department of Justice. He
25 was also a resident scholar at the American Enterprise

1 Institute.
2 Rick has authored numerous publications -- you
3 laugh --
4 MR. KIRKWOOD: Are you still welcome there?
5 DR. WARREN-BOULTON: Yes, for lunch.
6 MS. SCHULTHEISS: Old friends, huh, Rick?
7 He has authored numerous publications, primarily
8 in the application of industrial organization economics
9 to antitrust and regulation. He's served as an expert
10 witness in numerous cases, including the Department of
11 Justice, U.S. versus AT&T, and for the FTC in our FTC
12 versus Staples and Office Depot merger. He also was an
13 expert with the Department of Justice in the United
14 States versus Microsoft.
15 In addition, Dr. Warren-Boulton was recently a
16 consultant in support of the Ross-Simmons side in its
17 effort to convince the Supreme Court to reject
18 Weyerhaeuser's petition for certiorari. Rick is yet
19 another one of our panelists who has some connection to
20 the Weyerhaeuser case.
21 Rick, with that...
22 DR. WARREN-BOULTON: Thank you. You know you
23 are getting old when you start talking about when you
24 were an expert witness in the AT&T case.
25 MS. SCHULTHEISS: And now they have all

1 re-merged.
2 DR. WARREN-BOULTON: -- in 1981, and in terms of
3 my connection with this case, obviously I was -- I tried
4 to help Ross-Simmons in arguing to the DOJ and the FTC
5 that they should not file what they did, so it was a
6 complete failure, but I will just keep trying anyway,
7 because I might as well.
8 You know, the issue that I would like to talk
9 about here today is really a question as to whether or
10 not we need a test, or at the extreme, even a safe
11 harbor, and I think we need to distinguish between tests
12 and a safe harbor for cases of strictly what I would
13 call predatory overbidding to achieve monopsony power,
14 and I think what we are doing is, in the order of the
15 speakers here, we are going from general to specific.
16 You know, I think that the much more broader and
17 frankly more interesting question is exclusion, and I
18 think Tim is right when he says if you come away from
19 this with anything, it is, for heaven's sake, do not get
20 predatory pricing or predatory overbidding mixed up with
21 exclusion, and then I think Steve would say, do not get
22 it mixed up with raising rivals' costs, too, and I
23 agree, very much so, that those are two very important
24 questions.
25 I do not think that the analysis, nor the

1 implications for policy, are the same for the three of
2 them, and I think what I am going to talk about today
3 is, in fact, the least interesting and least important
4 of the three, but that is what I thought my topic was,
5 and so that is what I want to talk about.
6 You know, I want to begin by distinguishing
7 between an economic definition of predation and a legal
8 test for predation, because coming up with a definition
9 for predation is extraordinarily easy. Any of us can
10 define predation. I was thinking about it before. I
11 think it is the reverse of pornography. We all know it.
12 We don't know it when we see it, but we know how to
13 define it.
14 You know, testing predation or coming up with a
15 test for predation is very difficult, because a test for
16 predation involves a balancing of the costs and
17 probability of false positives against the costs and
18 probability of a false negative, and so finding the
19 right tests or the right safe harbors for each
20 distinguishable situation is fundamentally an empirical
21 question, and it's a different question for every
22 situation that you can distinguish.
23 What I think for us at the moment to think about
24 it is is a couple of implications of that for coming up
25 with tests for predatory overbidding to achieve

1 monopsony power. The first is, there is absolutely no
2 need to have the same rule for predatory pricing to
3 achieve monopoly power as predatory overbidding to
4 achieve monopsony power. You don't need to have the
5 same rule unless you can't tell the two situations
6 apart. But even a court, to be honest, it seems to me,
7 is unlikely to confuse predatory pricing with predatory
8 overbuying.
9 You know, when you have predatory pricing, you
10 look at the final product price, and it goes down, and
11 then it goes up, and when you look at predatory
12 overbidding, the initial price goes up, and then it goes
13 down. So, it seems to me that trying to order that you
14 need consistency between monopsony and monopoly
15 situations when what you are looking at is completely
16 different behavior seems to me to be unnecessary and
17 sort of pointless. It may not be the hobgoblin of
18 little minds, but there is absolutely no reason to say
19 that just because something is over here in the monopoly
20 world, that we should apply the same rule in a monopsony
21 world.
22 The second is, I think it is very easy to
23 distinguish between predatory overbidding and what I
24 think is going to be Janet's concern, which is between
25 predatory overbidding and either the exercise of

1 monopsony power or, more importantly, the exercise of
2 bargaining power by power buyers. When you have
3 predatory overbuying, what happens is your input price
4 goes up, and then it goes down. That is what we are
5 looking at today. When you are looking at bargaining
6 power, in my experience, input prices go down and then
7 they stay down. You know, power buyers like Wal-Mart
8 pay lower prices, you know, from the get-go. Wal-Mart,
9 to my knowledge, has never been accused of paying too
10 high a price, even temporarily.
11 Once more, of course, is you can distinguish the
12 output effect, the classic monopsony problem, is you buy
13 too little. You know, Wal-Mart buys a lot. So, it
14 seems to me, you know, there should not be much concern
15 here about false positives when we are facing
16 allegations of predatory overbidding, and I hope that
17 Janet will disagree strenuously, and I am sure she will,
18 because otherwise, it will be no fun at all, but the
19 result of this, I think just as a sort of preamble, is I
20 find no urgent need for a safe harbor to deal with
21 allegations of predatory overbidding to gain monopsony
22 power. I do not think we should expect a flood of cases
23 that might be false positives, that if we do not
24 immediately nip this in the bud by allowing a
25 Brooke Group safe harbor for predatory overbidding, and

1 I am certain Janet will disagree with that one.
2 The second point to me is there is no reason why
3 we can't proceed inductively, decide Ross-Simmons and
4 any of the other rare cases that arise on the merits,
5 and then try to generalize them. There are two
6 procedures here. Lawyers, in my experience, the idea is
7 that you have a whole bunch of cases, you try them on
8 the merits, and then you ask, "Gosh, is there some
9 common principle that's going on here?" It is very much
10 of an inductive reasoning process, and it works very
11 well.
12 I think the economist approach is highly
13 complementary. We go the reverse. We think
14 deductively. We think what are the first principles,
15 and we try to deduce, deductively, what the right
16 principles are, and, you know, with any luck, it is like
17 two people tunneling from opposite sides of the
18 mountain, you know, the lawyers going inductively and
19 the economists going deductively, and if all goes well,
20 we meet in the middle, and if we don't, we just keep
21 going until we get the other side, and we have two
22 tunnels.
23 But, you know, this strikes me as a situation in
24 which I think the lawyers -- I mean, look at how many
25 years we have been trying deductively to figure out what

1 the right principle to use is on predatory pricing for,
2 you know, on the output side. We can't figure out the
3 damned thing. I mean, you know, look how far apart
4 those two gentlemen are, opposite sides of the table for
5 God's sake. They are never going to agree. So, I think
6 that the deductive approach really -- I mean, I think we
7 have plenty of time to get a few more Ross-Simmons cases
8 and then figure out how to go on.
9 But let us suppose -- you know, at this point, I
10 think I could sit down and say there is no need for me
11 to proceed further, but unfortunately, my panelists
12 won't let me do that, and anyway, I think I have another
13 six minutes. So, let's ask the question. Let's suppose
14 that you did do the unnecessary thing and you did ask,
15 well, let's ask, what kind of tests should we sort of
16 come up with for predatory overbidding to achieve
17 monopsony power? And the question I think you want to
18 ask is, what are the questions we want to ask?
19 And I think you really want to ask things like,
20 is monopsony different from monopoly? Are bidding
21 markets -- because remember, this was specifically a
22 bidding case -- are bidding markets different from, you
23 know, other markets? And I think that the first answer
24 is -- on both of them is yes. If you look at the
25 difference between monopsony and monopoly, I have a

1 paper, which I am not posting on the web site until I
2 get a chance to sort of, you know, get all the
3 information, getting digs at Janet, so I will post it
4 later, but, you know, two of the main differences
5 between monopoly and monopsony it seems to me is
6 monopsony is much rarer, and it is easier to identify.
7 Monopsony is rarer for several reasons.
8 Basically supply inelasticity is much rarer than demand
9 elasticity. We all know this. Why is it? Well,
10 producers can substitute easier than consumers in
11 general, but most important, you know, in consumption,
12 diminishing returns, you know, the demand curve slopes
13 downwards, I mean, we all know that.
14 On the other hand, in production, the norm is
15 constant returns to scale, and so what we tend to get
16 is, you know, a situation in which -- I just -- you
17 know, I don't like -- I don't have a blackboard or a
18 white board, but if you were drawing a demand and supply
19 curve, you would feel perfectly normal drawing a
20 horizontal supply curve and a downward-sloping demand
21 curve, something which would look like this, but most of
22 you would think that what's somewhat less usual is to
23 have a completely horizontal demand curve, supply -- you
24 know, upward-sloping supply curve. I mean,
25 fundamentally, demand curves slope downwards. Supply

1 curves usually are horizontal. So, the reason why we
2 get that is I think because there's a real difference.
3 There is diminishing returns of consumption and
4 relatively constant returns on production.
5 The second thing is I think monopsony is much
6 easier to identify, monopsony power, for several
7 reasons. One is that supply inelasticity is really only
8 observed in a few situations, and when I stop and I
9 think about what they are, they are most importantly, in
10 my experience, when a product is a by-product of some
11 other product or when it is an exhaustible natural
12 resource. Both of those are very unusual, and, you
13 know, both of them actually apply in this particular --
14 in the Ross-Simmons case. Alder turns out to be a
15 by-product or what they call a come-along product in the
16 industry, and it is an exhaustible product. So, you can
17 use the screen essentially of a by-product as a -- to
18 limit the scope of any decision.
19 By the way, there is a second reason, which I
20 always find kind of fun, which is why observing
21 monopsony is so much rarer than observing monopoly.
22 Monopsony is inefficient, and so nearly all monopsony
23 situations or potential monopsony situations are solved
24 by vertical integration, okay? If you are an aluminum
25 plant and you are right next to an electricity dam and

1 you are the only buyer of electricity, you have
2 monopsony power towards that supplier, say, of
3 electricity, and exercising monopsony power can be
4 profitable. It is even more profitable, though, if you
5 buy the dam and get rid of the inefficiency.
6 So, vertical integration is profitable because
7 it gets rid of the inefficiency of monopsony, okay? But
8 vertical integration backwards is much, much easier than
9 vertical integration downwards and to the consumer, and
10 the nice test for this is if you ask where do we
11 actually see monopsony being exercised, in most cases,
12 it's situations where vertical integration is not
13 possible, and the classic example of that, at least
14 since the Civil War, is labor. You cannot buy people,
15 okay? And that is why the other day, you know, if you
16 were reading the New York Times, you would find that it
17 said a class action case, you know, on monopsony, who is
18 it? It is by a group of nurses who are being -- the
19 assertion is that they are being monopsonized. Now, if
20 the hospital could just buy the nurses, there would not
21 be a monopsony problem, okay? So, most monopsony cases
22 are in labor, because vertical integration does not
23 solve the problem.
24 All right, the second main difference that I
25 think we see between everything else we are talking

1 about is that these are, of the cases that we are
2 talking about here, Ross-Simmons, is it is a bidding
3 market, and the question is, just like monopoly is
4 different from monopsony, bidding markets are different
5 from markets in which there simply is single price. The
6 classic problem with predatory pricing has always been,
7 and I think it was Steve who introduced this, that it is
8 inherently implausible, because the cost to the predator
9 with a high market share is so much greater than the
10 harm to the victim.
11 If you have a 90 percent market share and you
12 engage in predatory pricing, you bear 90 percent of the
13 costs, and the guy with the 10 percent share bears 10
14 percent of the costs, and that is so stupid, you know,
15 that it is fundamentally implausible. The guy does not
16 believe you are going to keep shooting yourself in the
17 foot over and over and over again. So, it is sort of
18 hard.
19 But, you know, when you can price-discriminate,
20 if the potential competitor can price-discriminate, if
21 prices are individually negotiated, then the cost to the
22 predator is no longer linked to the market share. There
23 is no longer any connection between the relative cost of
24 the predator and the predatee, you know, and then market
25 shares, and so you have a fundamentally different

1 probability, you know, of a false positive here.
2 So, you know, my conclusion, looking at this, is
3 that if I am looking at the specific problem that we are
4 dealing with here, which is predatory overbidding to
5 achieve monopsony power, that if you have a combination
6 of three things, you have a very good probability of a
7 real case being there and a very low probability of
8 having a false positive. Those three things are a very,
9 very low supply elasticity of the input, which as I say
10 is almost always just when it is either a by-product or
11 a natural resource; secondly, the ability of the
12 predator to price-discriminate, particularly in bidding
13 markets; and third, very strong barriers to re-entry.
14 If you have those three things, then I think you
15 have basically passed sort of the structural criteria
16 that you need to pass. You don't pass -- you know, I
17 think you have to pass all of those three, but if you
18 pass those three, then I think you have a very good
19 argument here that the predatory overbidding to gain
20 monopsony power is, in fact, a realistic effort.
21 Recoupment, what I am basically saying, is very
22 likely, and then you do not need to get into the kind of
23 cost tests that are in Brooke Group that I think most of
24 us have looked at and said, the problem with these cost
25 tests is that they generate a very -- particularly if

1 you allow them as safe harbors, they allow a high rate
2 of false negatives. If you look at Ross-Simmons, it
3 fits all of those, alder is a by-product, prices are
4 individually negotiated, and the equipment that the
5 sawmills was using is actually specific to alder, okay?
6 If Ross-Simmons' equipment could have been used either
7 for alder or soft wood, then we would not be here. Then
8 basically, you know, Ross-Simmons could have been a
9 hit-and-run entrant. They could have come in, they
10 could have gone on, but the specificity of the equipment
11 means basically that there is a very high barrier to
12 re-entry.
13 If you look at those three criteria, I think it
14 merits what the Ninth Circuit sort of was saying. It
15 was saying that predatory overbidding for a resource
16 input in a highly inelastic supply, combined with a high
17 barrier to entry by the downstream firms, you know, that
18 is an extraordinarily narrow set of events, and if you
19 look at that and you combine that with a
20 no-economic-sense test, to understand the strategy and
21 say does it pass the economic sense, I do not think
22 there is any need for going into, you know, cost-based
23 tests. I think what we could basically do is accept the
24 Ninth Circuit decision, construe Ross-Simmons narrowly,
25 and we can all wait for the next 20 or 30 years to see

1 if another case ever turns up.

2 You know, finally, in terms of the two gentlemen
3 over here, you know, I think we owe an enormous debt of
4 gratitude to what used to be called the Chicago School,
5 but I guess in this case more the University of Virginia
6 school, for 40 years of reducing false positives, and I
7 think that is yeoman's work at the academic level. I
8 would like to believe that the Reagan Administration and
9 Bill Baxter and the people who came in with him were at
10 least sort of implementing that, but I think one thing
11 we should realize is that getting rid of false negatives
12 is a complement to reducing false positives.

13 We all know on deterrence that optimal penalties
14 are a decreasing function of the probability of a false
15 positive, and for those of you who do not quite
16 immediately know what that means, what it means
17 basically is now that we have DNA testing, the case for
18 capital punishment is much stronger. That is the
19 easiest way to think of it.

20 So, what has happened is we have an accumulated
21 experience, we have many cases of alleged predation, we
22 have economists working on it, and I think we have
23 greatly reduced the level of false positives, and I
24 think the problem is, of course, is once you have
25 reduced the probability of false positives

1 significantly, then it becomes efficient and desirable
2 to turn to the question of can we reduce the number of
3 false negatives. So, I think what we are seeing over
4 here, and I know Professor Elzinga is going to shoot me
5 for this, but I would say Professor Elzinga has made
6 Professor Bolton possible. I leave the two of you to
7 duke it out.
8 (Applause.)
9 MS. SCHULTHEISS: Our final speaker is Janet
10 McDavid. Janet McDavid is a partner in the Washington,
11 D.C. office of the law firm Hogan & Hartson, where she
12 focuses on antitrust and trade regulation, litigation
13 and counseling. She is widely recognized as a leading
14 authority in antitrust law, has been included in many
15 guides to top antitrust lawyers, and an author of many
16 books and articles on antitrust law.
17 Ms. McDavid was previously the Chair of the
18 Section of Antitrust Law of the American Bar Association
19 and also a chair of its committee on Section 2 of the
20 Sherman Act. As a member of the Antitrust Council to
21 the U.S. Chamber of Commerce, Ms. McDavid also brings to
22 us a business perspective.
23 In addition, of particular relevance, again, to
24 today's hearing, Ms. McDavid was a co-author of the
25 brief for the Business Round Table and National

1 Association of Manufacturers in support of
2 Weyerhaeuser's petition for certiorari, and Ms. McDavid
3 was also the lead author of a recent article in the
4 National Law Journal entitled "Predatory Purchasing?"
5 And at this, I give Janet the job of cleanup and
6 responding to some of the comments that have been made
7 thus far.
8 MS. McDAVID: I don't think my views will be
9 quite as extreme as Rick may have suggested. My
10 perspective here is that of a practicing lawyer who has
11 to try to advise clients on where the line is between
12 conduct that might be unlawful under the antitrust laws
13 and conduct in which they can engage with relatively low
14 risk, and Rick has suggested that greater clarity in
15 this area really is not necessary, we should just allow
16 the law to develop for a while and see whether
17 inductively or deductively we can establish some rules,
18 because the cases are rare.
19 I am not seeing dozens of these cases in my
20 practice, but I am increasingly seeing a lot of
21 monopsony questions coming up from my clients, and so I
22 do not think these cases are likely to be as rare as
23 perhaps has been hypothesized. I am hoping that these
24 hearings or the Weyerhaeuser case in the Supreme Court,
25 whichever comes out first, can provide an answer with

1 respect to the predatory purchasing conundrum that can
2 reasonably be applied by businesspeople and their
3 lawyers.
4 Remember, the purchasing department of even a
5 Fortune 100 company does not include these guys. They
6 would not know a downward sloping demand curve if it hit
7 them in the face. And so the notion that that is a
8 standard that can be applied by a businessperson in a
9 purchasing department is just unrealistic.
10 It is actually quite funny, I think, that Rick
11 referred to Justice Stewart's definition of pornography,
12 because that is also the analogy that I had here. I
13 think the --
14 DR. WARREN-BOULTON: Like minds.
15 MS. McDAVID: -- Ninth Circuit standard in
16 Weyerhaeuser provides much less guidance than Justice
17 Stewart's standard with respect to pornography. There
18 is no basis here for advising a client, and this is a
19 serious mistake, because ultimately, businesspeople have
20 to understand the rules. Justice Breyer, when he was
21 still on the First Circuit, said that antitrust rules
22 must be clear enough for lawyers to explain them to
23 clients and be administratively workable, and that in
24 formulating antitrust liability standards, the courts
25 must consider what advice the lawyer is going to give.

1 Chairman Majoras made essentially the same point
2 when she opened these hearings on Tuesday. The process
3 of distinguishing between the permissible and the
4 impermissible must be relatively consistent and
5 transparent so firms can incorporate it into their
6 decision-making.
7 So, where does that leave us with the Ninth
8 Circuit? We have a standard of liability that allowed a
9 jury, using 20/20 hindsight, to determine whether
10 Weyerhaeuser paid a higher price than necessary to
11 prevent Ross-Simmons from obtaining its inputs at a fair
12 price and that Weyerhaeuser may have purchased more logs
13 than necessary. How is a business person supposed to
14 apply that standard? It is entirely vague, open-ended,
15 and subjective. It gives us no way to draw the lines,
16 and a jury exercising its 20/20 hindsight can come out
17 in a completely different place than a perfectly
18 rational businessperson did.
19 I think it is significant that Weyerhaeuser
20 never lost any money on any of this. The division was
21 operating profitably the whole time. I reread the Ninth
22 Circuit decision this morning, and the Court talks about
23 the need for recoupment in order to render the strategy
24 profitable, but it does not actually impose that
25 requirement as part of the test. So, the Court gave lip

1 service to recoupment without ever requiring it as part
2 of the standard.
3 So, one of the effects of all of this is to prop
4 up less efficient firms, such as Ross-Simmons, that are
5 unable to operate profitably at the same input prices
6 that a more efficient rival can afford to pay. Now,
7 firms compete for inputs just as they compete for sales,
8 especially if the inputs are scarce, and there is
9 language in the Ninth Circuit's decision that suggests
10 that the inputs were becoming more scarce. They
11 certainly were not more plentiful. So, we have a
12 circumstance in which firms are going to be deterred
13 from aggressive buying by the threat of liability for
14 treble damages as a consequence of a standard that they
15 cannot understand and cannot apply.
16 How is a firm supposed to know if a jury will
17 later determine whether it bought more than it needed,
18 whether it paid a price that was too high, whether it
19 paid a price that was not fair? If it buys too much,
20 there are lots of reasons that that could have happened,
21 as Steve was explaining earlier. It might have decided
22 to stockpile inventory to preclude future shortages or
23 to hedge against a future price increase. That happens.
24 We had it happen, for example, during the
25 Hurricane Katrina circumstance. Oil companies had

1 inventories. They were able to sell it off during a
2 time of shortage. They might have overestimated their
3 needs. Businesses make mistakes. They might have
4 assumed that demand was going to increase, and it did
5 not. Again, businesses make mistakes. They may have
6 planned that sales were going to grow and guessed wrong,
7 or they may have chosen to deal with the predictable
8 supplier who has a reliable source and paid a slight
9 premium to do so.
10 Any one of these could, in hindsight, become the
11 basis for liability by a jury that is exercising a
12 standard based on fairness. Under no other circumstance
13 in the antitrust laws, except perhaps the regrettable
14 Robinson-Patman Act, do we consider a fairness standard.
15 It is simply not administrable. So, people like me will
16 have a hard time telling our clients what they should
17 do, and the businesspeople on the ground will have a
18 very hard time knowing what they should do and what they
19 can do safely and fairly.
20 Now, I will recommend to my clients, as I do in
21 all circumstances, that they document the reasons they
22 are doing things if they face a risk. I always tell
23 them that I would prefer to create our own legislative
24 history, that in the event the inevitable happens, I
25 would like there to be evidence in their files that

1 explains, without us having to go back and explain it
2 again, why they did what they did and that there was a
3 rational business reason for what they are doing. I
4 will also ask them, can you make money if you purchase
5 at X price? Now, the unfortunate thing is, while I
6 think that is a perfectly rational question to be
7 asking, it is not relevant to the analysis in the Ninth
8 Circuit, whether or not they were going to be able to
9 make money if they paid X price for their inputs.
10 I do not understand why the Brooke Group
11 standards should not be at least relevant to the
12 analysis here. These are standards that businesspeople
13 actually can understand. Very few of my clients have
14 ever known what their average variable cost is, but they
15 do know, if we talk about it in kind of gross terms, if
16 you pay X or if you charge X, will you make money or
17 will you be operating at a loss?
18 They also can understand the notion of whether
19 or not it will be profitable in the longer term. These
20 are standards businesspeople can understand, and the
21 courts have got to give them some kind of guidance here,
22 and if the courts fail to do so, I hope that these
23 hearings will, because without it, the businesspeople
24 are going to be left largely rudderless.
25 MS. SCHULTHEISS: Thank you, Janet.

1 (Applause.)
2 MS. SCHULTHEISS: I would like to thank all of
3 our panelists, and we are going to take a brief
4 ten-minute break, after which we will reconvene and have
5 a directed discussion with some questions. Thank you.
6 (A brief recess was taken.)
7 MS. SCHULTHEISS: Okay, let's get started with
8 the second part of our panel, which is the discussion
9 period, and before I start asking some specific
10 questions of the panelists, I would like to see if I can
11 get some consensus from the panelists on some of the
12 terms we are using and whether we are understanding them
13 correctly.
14 As I am hearing the presentations, I hear that
15 you are talking about two different things. You are
16 talking about predatory conduct that affects the input
17 suppliers and the price of the input supplies, and
18 another area is the predation or predatory conduct that
19 is directed at affecting your competitors in the output
20 market. Is that correct?
21 Let's just start with Jack and let's just go
22 through the panelists and see what you think. Is that a
23 correct statement?
24 MR. KIRKWOOD: I am not sure I would put it
25 exactly that way. I think that Steve's distinction is a

1 good one, that if you as the dominant firm could raise
2 the input costs of a rival, and the question is whether
3 your ultimate goal is monopsony power or, instead,
4 downstream market power, and the first I have called
5 predatory bidding, as did the Ninth Circuit, Steve has
6 called it predatory overbuying. The second category, it
7 could come from predatory bidding, as I explained, but
8 the second category is more typically described as
9 raising rivals' costs, or as Tim would say, exclusion,
10 and maybe Tim could address the question of to what
11 extent is exclusion different from raising rivals'
12 costs.
13 MS. SCHULTHEISS: Tim?
14 DR. BRENNAN: Well, I agree with what Jack said.
15 Again, I agree with the distinction as he put it or, you
16 know, that Steve made. I would not call both predatory,
17 because as soon as you do that, then you start using
18 predatory tests in both contexts, and I think for
19 reasons that I have argued and Steve has suggested as
20 well and others, that I think those are inappropriate.
21 The main reason I make the distinction, I mean,
22 I suppose there is a bit of a long story here, but just
23 to keep it short, the two are -- well, first, when you
24 say that the harm from something involves hurting
25 rivals, then I think you invite people to go back into

1 predation land, and I would rather call it something
2 else, and the reason I would call it the something else,
3 when I am calling it complement market monopolization,
4 is that in order to exclude people, in order to raise
5 their costs, whatever it is, you have to create and
6 exercise market power over something that they need, and
7 because antitrust authorities have ways of thinking
8 about that sort of thing, that is what we do with
9 mergers, that is what we do with cartels, you could in
10 some sense take an enormous part of -- as Steve, I
11 think, aptly put it -- the great lion's share of Section
12 2 cases and get them out from under the controversy that
13 attaches to them because of the view that what Section 2
14 is about is in some sense about competing so hard that
15 people get hurt too much.
16 MS. SCHULTHEISS: Steve, would you like to
17 address that?
18 DR. SALOP: Yes, sure, I agree with Jack that I
19 got it right.
20 DR. BRENNAN: I figured it was relatively safe.
21 DR. SALOP: I agree with the first two sentences
22 of what Tim said. I think when you use the term
23 "predatory," it is a loaded term. I never really liked
24 the term "nonprice predation" for that reason. That is
25 why I like calling it exclusion or raising rivals'

1 costs.

2 Now, nonprice predation sometimes involves
3 prices, like here, prices are involved, and when you
4 call it predation, that tends to plug into Brooke Group,
5 and as I said, I think there are two vastly different
6 paradigms.

7 MS. SCHULTHEISS: So, in terms of what we are
8 speaking about here today, Rick focused on the narrow
9 with the predatory overbidding or overbuying that is in
10 the Weyerhaeuser case, but then there is a separate area
11 of conduct that involves some type of exclusionary
12 conduct, what you call raising rivals' costs, what Tim
13 might call exclusion, and looking at the complementary
14 market.

15 DR. SALOP: I think what all three of us were
16 taking issue with in your question was the word
17 "predatory." Had you just said "conduct that gives
18 market power in the input market" and "conduct that
19 gives market power in the output market," we all would
20 have --

21 MS. SCHULTHEISS: Do you all agree with that
22 one?

23 DR. BRENNAN: More or less.

24 MS. SCHULTHEISS: What about you, Rick?

25 DR. WARREN-BOULTON: First of all, yes, I think

1 they are enormously different. I think that the first
2 is monopsony and the second is monopoly, and I think it
3 is incumbent upon a plaintiff to say which one -- which
4 world he's in. I agree that the false positive/false
5 negative trade-off is enormously different between the
6 two. I don't see how people can really -- or people
7 should not confuse them. I don't think they are
8 particularly relevant. I think all three of those
9 situations should be handled, you know, quite
10 separately, because they have different structure
11 requirements.
12 The final question, would I distinguish them in
13 terms of predation/nonpredation, no, I would distinguish
14 them I think in terms of, you know, simple pricing
15 versus, you know, more complex exclusion, you know,
16 price or nonprice. I mean, most of the really
17 interesting problems here really are exclusion done in
18 interesting and complicated and strategic ways and how
19 do we handle that. But again, I think at the very
20 beginning, it is really incumbent on people to say which
21 box they are in in any case.
22 MS. SCHULTHEISS: Janet?
23 MS. McDAVID: I think that Steve and Jack got it
24 right from my perspective.
25 MS. SCHULTHEISS: Okay. In terms of the

1 antitrust agencies, would you agree, then, that we
2 should be more concerned with the latter category, that
3 being, if you want to call it, either the exclusionary
4 conduct or raising rivals' costs, versus the pure
5 predatory buying towards, you know, monopsony over the
6 input market? And I would wonder -- I want to find out
7 if you agree with that.
8 MR. KIRKWOOD: I would be inclined to agree with
9 it, yes. I have not done the kind of research that
10 Steve has done into the frequency of raising rivals'
11 costs problems, but from what I have read of what he and
12 others have written, it seems to be a more common
13 problem. One of the key elements of the analysis of
14 predatory bidding we have done is that it seems to be
15 quite rare. So, yes, in terms of where you would target
16 your enforcement resources, sure, surely.
17 MS. SCHULTHEISS: Tim?
18 DR. BRENNAN: Yes, mostly for the reasons Steve
19 said before, that the predation parts of things, whether
20 it is buying or selling, are going to be rare for the
21 reasons he outlined and I do not need to repeat, and so
22 for that reason my expectation would be to worry about
23 things where people do not have to sacrifice a lot and
24 take a lot of risks in order to get some speculative
25 benefit down the road.

1 MS. SCHULTHEISS: Steve, I take it you agree.
2 DR. SALOP: Yes, I agree with what they said,
3 but they didn't answer your question, which is, well,
4 what the agency should not be doing, and frankly --
5 MS. SCHULTHEISS: I do not know if it is
6 necessarily what we should or should not, but our
7 primary focus. Should we be worried about one more than
8 the other?
9 DR. SALOP: The way you phrased it is something
10 that I think is all too apparent in this administration,
11 which is you are spending an awful lot of time deciding
12 what you should not do, and you are not doing a heck of
13 a lot, and so I think that in the exclusionary conduct
14 area, the agencies ought to get involved and start
15 looking for exclusionary conduct cases rather than
16 protecting monopolists.
17 MS. SCHULTHEISS: Okay.
18 DR. WARREN-BOULTON: I think I am probably
19 agreeing with everybody. First of all, I agree that --
20 I mean, the whole point is that, you know, predatory
21 overbidding to get monopsony power, as I said, is
22 incredibly rare. So, the answer to the first question
23 is yes, and oddly enough, I would agree with Steve that
24 I think exclusion is a real problem, and so if you are
25 going to spend more money on something, I would have you

1 spend it on exclusion.
2 MS. SCHULTHEISS: Janet?
3 MS. McDAVID: I would urge the agencies actually
4 to play a role in the Section 2 enforcement area
5 generally, because too often these cases arise in the
6 context of disputes between business rivals, each of
7 whom brings baggage, whereas the agencies are trying to
8 do the right thing, and a case that an agency brings has
9 been vetted carefully as opposed to just being the
10 pissing contest between somebody who may have been
11 forced out of business and thinks that, of course, it
12 was unfair and something must have been wrong, it
13 couldn't have been an inefficient firm, it couldn't have
14 been incompetent. The agencies, I think, bring an
15 important balancing rule to the enforcement in the
16 Section 2 area generally and in this area as well.
17 MS. SCHULTHEISS: Let me ask you another
18 question, Janet, because you were talking about in terms
19 of counseling clients and what have you. Would you
20 agree, then, with Rick and most of the other panelists,
21 I think, that the overbidding or overbuying that we see
22 in the Weyerhaeuser case is an unusual situation?
23 MS. McDAVID: I have not seen a lot of this. I
24 think it probably is an unusual situation, but the
25 plaintiff's bar is extremely entrepreneurial, and I do

1 not think we should assume that it will continue to be
2 an unusual circumstance.
3 MS. SCHULTHEISS: So, you --
4 MS. McDAVID: And virtually every major firm in
5 this country sues in the Ninth Circuit. So, unless the
6 law gets clarified, I think we will see these cases
7 because they will get syndicated.
8 MS. SCHULTHEISS: Steve, did you want to say
9 something in response to that?
10 DR. SALOP: Yes, I just wanted to -- I just
11 jotted down some overbuying cases before, and so I know
12 we see sort of the classic, you know, Ross-Simmons cases
13 being rare, but one, as I said before, Ross-Simmons
14 alleged raising rivals' costs as well as -- as well
15 as --
16 MS. SCHULTHEISS: Right.
17 DR. SALOP: -- predatory bidding, and in terms
18 of the history of antitrust, you know, among sort of the
19 cases I teach and run across, we have got not just the
20 timber cases, we have got the tobacco case was an
21 overbuying case, the beef case, the Monfort case that --
22 I mean, the beef case was a conspiracy in overbuying,
23 the Monfort case was about overbuying, went to the
24 Supreme Court, Socony-Vacuum was about overbuying, Alcoa
25 had a piece that was involved in overbuying, and in

1 terms of what is going on right now, stuff the agency
2 has in its shop, all the stuff about shelf space is all
3 about overbuying, too, you know, could be thought of as
4 an overbuying issue. There could be overbuying of
5 patents. Alcoa, you know, allegedly tied up some
6 patents, so it made it harder for people in -- not sort
7 of classic predatory bidding, but, you know, you could
8 certainly have overbuying of patents, too.
9 So, I do not think it is a -- I think this idea
10 that it is just exhaustible resources that are
11 by-products, I know that covers the old molybdenum case,
12 one of my favorite cases when I was at the FTC, but I
13 think it is rather broader than that.
14 DR. WARREN-BOULTON: Can I just make a -- I
15 mean, I have not gone back and looked at the cases, but
16 I would question how many cases are there --
17 MS. SCHULTHEISS: Can you speak into the
18 microphone?
19 DR. WARREN-BOULTON: I'm sorry, how many cases
20 are there in overbidding to gain monopsony power. Steve
21 cites a tobacco case. I do not think that was to gain
22 monopsony power for tobacco growers. I thought that was
23 to exclude other, you know, cigarette producers. The
24 beef case, I do not think they ever managed to -- it was
25 ever shown that they ever managed to raise the price of

1 anything. The others I cannot remember, but, I mean, I
2 guess the question is, are there any cases other than
3 Reid, which was I don't know how long ago, and
4 Ross-Simmons that are predatory overbidding to achieve
5 monopsony power? I mean, I do not want to say sui
6 generis, because I do not know how to pronounce it
7 correctly, but it has got to be something like that.
8 Sui?
9 MS. McDAVID: Sui.
10 DR. WARREN-BOULTON: Sue me, sue you.
11 MS. SCHULTHEISS: All right, Jack would like to
12 say something.
13 MR. KIRKWOOD: Yes, Steve is certainly right
14 that there have been a number of overbuying allegations,
15 but if you look narrowly at how many of these cases are
16 predatory bidding cases, American Tobacco, as Rick and I
17 discussed last night, that seems fairly clearly a
18 raising rivals' costs case as opposed to a predatory
19 bidding case, because the kind of tobacco the major
20 producers bid up was a tobacco they did not use at all
21 and continued not to use it. So, they were not trying
22 to get monopsony power in it, because they were not
23 using it as an input.
24 And in beef, though there was a predatory
25 bidding allegation, as Rick suggests, they were not able

1 to raise the price at all. And in Socony, that was
2 behavior designed to facilitate a cartel. Monfort had a
3 predatory bidding concern, but it was a concern raised
4 as part of an effort to enjoin a merger. So, there was
5 not any actual evidence of predatory bidding, and the
6 Court analyzed it as a predatory pricing case.
7 MS. SCHULTHEISS: Steve, and then I want to get
8 Janet's reaction.
9 DR. SALOP: Of course, the Supreme Court
10 misanalyzed Monfort, but putting that aside, I mean, I
11 agree, a lot of these are not predatory overbuying
12 cases, they are other things, but the Ross-Simmons jury
13 instruction does not require you to show anything other
14 than they paid more than necessary or bought more than
15 necessary or paid more than a fair price. So, all of
16 them would be swept in if we go inductively and just
17 allow the Ross-Simmons jury instruction to stand and
18 screw things up for another 15 years until Ken has to
19 get involved and clean up the area.
20 MS. McDAVID: That is precisely my concern, is
21 that if this is the law in the Ninth Circuit, virtually
22 anything can be brought as one of these cases, and they
23 probably will not be tried to judgment in the end,
24 because the defendants cannot take the risk of trying
25 those cases to judgment with the treble damages burden.

1 MS. SCHULTHEISS: I am going to let Tim have the
2 last word on this particular point, and then I would
3 like to move on.
4 DR. BRENNAN: I think that the reasons that Rick
5 in particular elaborated on why these cases would be
6 rare in terms of the circumstances of the market,
7 exhaustible resources, the bidding market and stuff, I
8 think those are all important to keep in mind. I do not
9 think, though -- one should be careful about making the
10 distinction, one, between buying and selling, because
11 that can be just an arbitrary function on the nature of
12 the market.
13 Let me give you an example, which is pipelines.
14 I don't know as much -- I don't know as much now about
15 how the pipeline sector works as I used to, but
16 pipelines are kind of funny in the following sense: The
17 way oil pipelines worked is that they sold oil pipeline
18 delivery services to oil wells basically. The way the
19 gas pipeline industry worked was that they bought gas
20 from gas wells and then resold it at the end of the
21 pipeline. If the oil pipeline was exercising market
22 power against the oil wells, it would involve monopoly,
23 that they were raising the price of pipeline services.
24 If they were -- if the gas pipeline was exercising
25 market power against the gas wells, it would be

1 monopsony. They would be driving down the price they
2 paid for the natural gas.
3 The triangles, the welfare losses, the dead
4 weight stuff, all that stuff would be exactly the same
5 in both cases, at least qualitatively it would be the
6 same, but one's monopoly and one's monopsony, and so
7 it's purely in some sense a -- I don't know, I won't say
8 it's arbitrary or artificial, but it is the way those
9 markets just happen to work. So, one needs to be
10 careful about making a distinction in that way, that one
11 can turn monopoly into monopsony in some sectors without
12 a great deal of difficulty.
13 DR. WARREN-BOULTON: Yes, I --
14 MS. SCHULTHEISS: Rick is going to have to get
15 the last word I see.
16 DR. WARREN-BOULTON: -- I very much agree. You
17 can be regarded as buying a service or selling, and it
18 can be based on form. I think one implication that I
19 think is kind of interesting is that in terms of a
20 welfare loss, you know, the idea that somehow welfare
21 losses are only important if they happen downstream
22 rather than upstream strikes me as kind of bizarre.
23 MS. SCHULTHEISS: Let's get to that in a second,
24 because I want to get to that issue.
25 DR. WARREN-BOULTON: But that is one of the

1 reasons why, because we can characterize it as upstream
2 or downstream sort of at will.
3 MS. SCHULTHEISS: Okay. Does everybody agree
4 that the jury instruction in Weyerhaeuser was just
5 wrong?
6 MS. McDAVID: Yes.
7 MS. SCHULTHEISS: Is there anybody that
8 disagrees with that?
9 DR. WARREN-BOULTON: You know, I am an
10 economist, I am not an attorney. If I was giving a set
11 of jury instructions to a group of economists, it would
12 be quite different from those instructions.
13 MS. McDAVID: How about if they were grocers and
14 guys who pump gas, because that is who your jury is made
15 up of.
16 DR. WARREN-BOULTON: So if I had a set of
17 instructions that said something like if you were a
18 group of economists and I wanted to have a recoupment,
19 how would I say that in a way that a group of grocers
20 would understand? You know, maybe this is the best way
21 the Court could think of to explain it to a group of
22 grocers. I'm not sure it would have been a better
23 result if we would have explained it in sort of
24 mathematical formulas.
25 MS. McDAVID: It probably would have been worse.

1 DR. WARREN-BOULTON: The question is, what does
2 the audience grasp?
3 DR. SALOP: You think saying they bought more
4 than necessary is a good proxy for recoupment? Is that
5 what you just said?
6 DR. WARREN-BOULTON: No, paying more than
7 necessary, it seems to me to be to a -- I don't know, an
8 ordinary person's idea of was there a profit sacrifice
9 here, all right, which is at least one element.
10 MS. SCHULTHEISS: But in terms of precedent, how
11 can that possibly -- you are just agreeing with the
12 statement I just said, then. You would not have that
13 kind of an objection to the standard that was set out in
14 the jury instruction.
15 DR. WARREN-BOULTON: You know, I am saying
16 anybody here, I think anybody here could probably today
17 come up with a better set of jury instructions than
18 that. How bad it is, I do not know.
19 MS. SCHULTHEISS: I do want --
20 DR. SALOP: Do you think a reasonable jury could
21 reach the right conclusion if they tried to apply that
22 jury instruction?
23 DR. WARREN-BOULTON: You know, actually, I have
24 been on a jury, and I have to tell you that my personal
25 experience is that what a jury decides has little, if

1 nothing, to do with the jury instructions. I was on a
2 cocaine bust jury in the District of Columbia, and we
3 convicted him of carrying a machete. We did that
4 because two people in the room said under no conditions
5 would I convict a male in the District of Columbia
6 carrying cocaine. We decided that he should go to jail
7 for three months, and we cast around to try to think of
8 what kind of thing would get him to jail for three
9 months. So, we convicted him of carrying a machete,
10 so...
11 MS. SCHULTHEISS: All right, I get the point.
12 There have been some different standards put
13 out, and I would like to get some input, because it
14 appears -- I mean, we have talked about consumer
15 welfare, we have talked about total welfare, no economic
16 sense, and they have come into play in different ways,
17 and I would like to start with you, Janet.
18 Which of the standards do you think makes most
19 sense in this type of a case, in the case where you are
20 dealing with either overbidding or some kind of
21 overbuying situation?
22 MS. McDAVID: Well, I am taken with Steve's
23 standard, which is effectively a rule of reason analysis
24 applied to the sort of circumstances we have here and
25 which incorporates as part of the analysis the Brooke

1 Group test, because I think it gives us some grounding.
2 MS. SCHULTHEISS: In dealing with the Brooke
3 Group test, though, then, do you have to have power then
4 in the output market in order to get that recoupment?
5 MS. McDAVID: You have to be able to make it up
6 somewhere, and exactly where you are going to make it up
7 might vary based on the particular circumstance and as
8 to whether it's a raising rivals' cost case or a
9 predation sort of case.
10 MS. SCHULTHEISS: But if you are recouping
11 solely on the input side, on the supply-side, then you
12 really do not necessarily have the consumer welfare
13 harm.
14 MS. McDAVID: You may not.
15 MS. SCHULTHEISS: And in that case, would you
16 find that there would not be a violation or there should
17 not be an antitrust violation found?
18 MS. McDAVID: I am actually not terribly
19 troubled by also applying the antitrust laws and
20 allowing the victim to be the supplier, just as we do in
21 the cases Gail used to investigate when she headed the
22 health care shop where we looked at large insurance
23 companies and whether they were going to acquire
24 sufficient power over doctors and hospitals. I think it
25 is a reasonable inquiry.

1 MS. SCHULTHEISS: So, the consumer welfare test
2 should not necessarily be the end all and be all, okay.
3 MS. McDAVID: Not the exclusive. It should be
4 the major concern, but it would not exclude entirely
5 concern to suppliers.
6 MS. SCHULTHEISS: Okay, Rick?
7 DR. WARREN-BOULTON: Yes, I just categorically
8 disagree strenuously. I mean, I just do not see any
9 difference between a dollar in producer surplus that
10 goes to some guy who is growing timber and a dollar to a
11 guy who is buying a unit of lumber, nor do the Merger
12 Guidelines. I mean, I think the economics literature is
13 absolutely unambiguous on this. The welfare losses from
14 monopsony are, you know, the same as the welfare losses
15 from monopoly, consumer surplus.
16 I mean, I think Roger Noll wrote a very nice
17 article right before everybody else's article that
18 basically walked through that, you know, and as Tim
19 points out, is that, you know, trying to find some
20 distinction as to whether or not it is upstream versus
21 downstream is completely arbitrary. It certainly cannot
22 be a distinction that says, "Gosh, if it is a loss by
23 producer, it does not count."
24 In that case, what you say is all input
25 monopolies are legal? I mean, you do not care if it is

1 an input monopoly because, you know, the thing is bought
2 by a firm who does not necessarily pass it on? I mean,
3 the idea of restricting this to consumer surplus to me
4 is bizarre. I think basically you have got an
5 externality test, basically says I have got the bad guy
6 who is doing something, and the question is, is he
7 hurting the rest of society? And the rest of society
8 are the people he sells to and the people he buys from,
9 and those people stand, you know, on the same footing.
10 So, you know, I think what we used to call a
11 consumer welfare test when we were trying to read the
12 names back in the good old days is the sum of consumer
13 surplus and producer surplus. I think what most of us
14 say is you ignore the profits of the monopolist, but
15 that is it. Everybody else is in.
16 MS. SCHULTHEISS: Steve, is that what you mean
17 when you say consumer welfare or consumer harm?
18 DR. SALOP: No, I thought my slides were very
19 clear on that, and I have got actually a paper that I
20 submitted to the Antitrust Modernization Commission on
21 this issue. I think by consumer welfare I mean true
22 consumer welfare. I think that people who want to say
23 suppliers, losses to supplier welfare should be enough,
24 should consider whether they think harm to competitors
25 should be enough to carry an antitrust violation, and

1 the Supreme Court has made it very clear that harm to
2 competitors is not enough, and I think the same thing
3 should be true with harm to suppliers.
4 The tricky part of this -- and I am sorry, this
5 is kind of a long answer -- the tricky part is that it
6 is quite clear to make an agreement --
7 MS. SCHULTHEISS: Could you speak more into the
8 mic? I'm sorry.
9 DR. SALOP: I'm sorry.
10 It's quite clear that naked agreements among
11 competitors, buyer-side competitors, to fix prices that
12 they make to inputs is illegal and should be per se
13 illegal, and --
14 MS. SCHULTHEISS: Well, that is horizontal,
15 though.
16 DR. SALOP: But that is where antitrust starts.
17 MS. SCHULTHEISS: Right.
18 DR. SALOP: So, I think it is worth thinking
19 about that case, because a lot of people that I have
20 talked to when I say it should be about consumer harm,
21 not about supplier harm, they pretty quickly think about
22 the buyer cartel cases, and the way I would distinguish
23 is even in the buyer cartel side in the following way:
24 Suppose you have an agreement among competitors
25 to jointly set -- I will not use the loaded term

1 "fix" -- to jointly set the price that they pay for
2 inputs. I think if that is naked, it is quite clear
3 that is per se illegal and should be per se illegal, but
4 to the extent that they have a justification, a
5 procompetitive, i.e., pro-consumer welfare justification
6 for that, then it ought to -- and I think it does -- go
7 into the rule of reason, just like in VMI.
8 If a group of sellers jointly sets a price, it
9 goes into a rule of reason if they have a procompetitive
10 justification for their actions, and then when you get
11 into the rule of reason, I think it makes sense that
12 consumer welfare rules, that it is not enough -- once
13 they show that consumer benefit, then the burden would
14 go to the plaintiff to prove that consumers are harmed.
15 It is not enough to show suppliers are harmed, and it is
16 not, I do not think, a balancing between the losses to
17 the input suppliers versus the effect on consumers and
18 versus the gains to the buyers that engage in the joint
19 price setting.
20 So, you know, I think antitrust is a consumer
21 welfare prescription, it is about consumer welfare, and
22 we should stick with that. We should stick with that
23 here, particularly in a situation where -- you know,
24 with this overbuying, where in a standard case,
25 consumers gain in the short run from it, just as they

1 gain in the short run during the predatory period from
2 predatory pricing.
3 MS. SCHULTHEISS: Okay, Tim?
4 DR. BRENNAN: A few very quick observations.
5 First, I just happened to go to the AMC deliberations on
6 mergers last week, and the only thing -- almost the only
7 thing they argued about was the welfare standard, and
8 the only arguments in favor of the consumer welfare
9 standard that were given were essentially critical
10 rhetoric, that the basis of public support for antitrust
11 is if people believe it is about consumers rather than
12 about the economy as a whole, but there was not a
13 substantive argument offered in its favor. So, I do go
14 with that.
15 As far as the harm to competitors being unduly
16 counted goes, I suspect that in these cases, that is
17 balanced out by profits to the perpetrator or gains to
18 the consumers or someplace, that that is all going to be
19 just a transfer, and you still end up with the assorted
20 dead weight losses versus efficiencies that we are
21 familiar with.
22 As far as what sort of tests to use, more
23 specifically, on what I would call the exclusion cases,
24 I basically view those as essentially horizontal, taking
25 up an ever larger share of this complement market

1 through exclusive dealing contracts or whatever it might
2 be and that we have horizontal tools for looking at
3 that. So, that is what I would use there.
4 On the predatory buying or predation cases
5 generally, I do not know enough to know at what point
6 one hits that balance between type I and type II error,
7 but that to me is what it is about, I think rather than
8 attempting to get each case exactly right, and I am just
9 going to leave it at that.
10 MS. SCHULTHEISS: I am going to let Steve make a
11 quick response and then Jack.
12 DR. SALOP: I am not surprised that the AMC was
13 confused during the hearings on the welfare standard.
14 Rick Rule testified that Bork used the Williamson
15 Diagram, he called it consumer welfare, as Rick said,
16 that was the old days when we were trying to confuse
17 people. The Supreme Court cited the Bork book.
18 Therefore, what the Supreme Court meant by consumer
19 welfare is total welfare, and that is the law, you know,
20 so I can certainly see why the AMC would get confused.
21 With respect to what the law ought to be, you
22 know, I think it is a complicated argument, but to Tim I
23 would say the following: It is not just a transfer.
24 Suppose you have entry into an industry by a relatively
25 high-cost entrant, enters the market, prices begin to

1 come down, benefiting consumers, and then the
2 monopolist, which has got much lower costs, kills the
3 entrant, prices go back up, suppose demand is relatively
4 inelastic? Well, in that situation, the killing of the
5 entrant would raise total welfare, and I thought you
6 said in your statement that standards like that were no
7 good, but regardless of what you said, it is quite clear
8 that that is conduct that I think ought to be illegal.
9 MS. SCHULTHEISS: I want to get to Jack now.
10 MR. KIRKWOOD: Sure, sure. We are looking at
11 various welfare standards now, which is inevitably a
12 somewhat complex topic. One choice is between total
13 welfare and what Rick called third-party welfare, so let
14 me just talk about total welfare versus consumer
15 welfare.
16 That is ultimately a value choice. You can
17 think of the famous Williamsonian case where the merger
18 lowers cost but raises price. My value judgment is that
19 antitrust ought to stop that. There are arguments pro
20 and con, but the legislative history seems to reflect
21 that judgment, and every court that has ever faced that
22 issue has come out the same way.
23 On the more difficult and more judgmental choice
24 of supplier welfare versus consumer welfare, I agree
25 with much of what Steve said and originally wrote my

1 article using a consumer welfare test, even in monopsony
2 cases, because generally there is a link between the
3 adverse impact on suppliers and the adverse impact on
4 consumers, but people raised two issues with me.
5 One, what about the case law? The case law
6 generally favors supplier welfare in a monopsony or
7 cartel case, and two, what about those instances, of
8 which Steve has described, where there is an adverse
9 impact on suppliers, suppliers are exploited, just like
10 in that merger, prices to them are lower, but no impact
11 whatsoever on consumers? Does that allow the practice?
12 And it does not seem it should.
13 DR. WARREN-BOULTON: Can I just make an example,
14 and I am responding really to Steve, to his statement
15 that somehow once we start talking about producer
16 welfare, we have to take into account the welfare of
17 competitors, and I do not think that is true. Let me
18 give you an example.
19 Suppose that I am a Kansas wheat farmer, and
20 what I do is I burn down all my neighbor's fields in the
21 county. Now, do we have a harm here? Yes. The
22 question is, is it an antitrust harm?
23 Now, you know, it is unlikely to me that I am
24 going to burn down all my neighbor's wheat farms because
25 I think that as a result, you know, there will be a

1 shortage of wheat and I will be able to raise the price
2 of wheat. So, I do not have any consumer harm at all.
3 Let's suppose that there is no input problem at all.
4 Then I typically have harm. I do not have an antitrust
5 harm. I still presumably go to jail for arson, right?
6 So, I have harm, but it is not an antitrust harm.
7 Antitrust harm gets triggered when I have a
8 market impact, and it could be one of two things. It
9 could be that I really burn down enough wheat to
10 actually raise the Chicago price of wheat, unlikely, but
11 if somebody came to me and said, you know, what the guy
12 did is he burned down all his neighbor's wheat farms,
13 and why did he do it? He said because there is a local
14 labor market for workers, and if I burn down and put out
15 of business all my local -- you know, who are with me in
16 the local labor market, I will be able to reduce the
17 prices I have to pay my workers.
18 Now, that is monopsony. Now, do I think that is
19 an antitrust violation? Yes, I would say that that is
20 an antitrust violation. I do not care whether it is
21 raising the price of wheat or reducing the wage rate of
22 farmers, nor do I think, in particular, that somehow
23 that one, you know, on some ethical standard, they are
24 any different. In fact, wheat bread consumers are
25 probably richer than farm laborers. So, there is some

1 distinction. I do not think you have to say that
2 somehow by bringing in producer surplus, we are somehow
3 worrying about competitors.
4 DR. SALOP: Well, you said something very
5 different. You said you would be willing to find an
6 antitrust violation where there is no consumer harm.
7 That is different from saying that you are adopting the
8 total welfare standard as the overarching standard to
9 govern antitrust cases, because if you were adopting the
10 total welfare standard to govern antitrust cases, then
11 the simple business tort of burning down your neighbor's
12 fields would lower total welfare, and it could support
13 an antitrust violation.
14 Certainly if you and your neighbor burned down
15 everybody else's fields, so you would not get into all
16 this complexity --
17 MS. SCHULTHEISS: Let's deal with a single firm,
18 which is what we are really focusing on.
19 DR. SALOP: Actually, we are not. We are
20 focusing on what the welfare standard should be.
21 MS. SCHULTHEISS: Right, but in connection with
22 Section 2.
23 DR. SALOP: Well, why would you have a different
24 welfare standard for Section 1 and Section 2? Why would
25 you want to make -- why would you want to gerrymander

1 antitrust and make it incoherent? You know, Tim pointed
2 out this notion of the pipeline, you know, if you have
3 different rules governing how -- if the rules are very
4 different according to whether the pipeline does a
5 tolling agreement where they sell services or whether
6 they buy the gas and resell it at the other end, you are
7 going to have incoherent antitrust. If you are going to
8 have dramatically different rules for tying, exclusive
9 dealing, vertical mergers, where one's per se illegal,
10 one's rule of reason, and one's virtually per se legal,
11 well, since lawyers can characterize conduct pretty
12 easily as any one of those three boxes, you are going to
13 end up with very incoherent antitrust, which we did
14 until the eighties. So, I think saying this is Section
15 2, not Section 1, that is a recipe for disaster.
16 MS. SCHULTHEISS: Janet, did you want to respond
17 to that?
18 MS. McDAVID: No.
19 MS. SCHULTHEISS: Okay. Rick?
20 DR. WARREN-BOULTON: Well, the broad question
21 is, gee, do we have to have the same rules in every
22 situation? My answer is no. If you can distinguish
23 between situations, then you can have the same rules --
24 you can have different rules. There is no --
25 MS. SCHULTHEISS: But would the test be the

1 same?

2 DR. WARREN-BOULTON: Sure. I mean, I think the
3 test for naked price-fixing is different than the
4 test -- you know, for the safe harbor for naked
5 price-fixing is very small. I think the safe harbor
6 for, you know, predatory pricing should be quite large.

7 MS. SCHULTHEISS: No, I mean in terms of the
8 consumer welfare versus total welfare, that test should
9 be the same across all of the violations or different?
10 Steve is arguing I think that it should be the same
11 welfare test regardless of the violation.

12 DR. WARREN-BOULTON: Oh, I see, yes. You can
13 argue what is the best welfare, but somehow suppliers
14 are upstream or downstream, welfare does not change
15 depending on --

16 MS. SCHULTHEISS: So, you agree with Steve,
17 then, that whatever welfare test -- whatever welfare
18 test is chosen should apply across all of the various
19 violations you're looking at?

20 DR. WARREN-BOULTON: As long as he chooses my
21 welfare test, then --

22 MS. SCHULTHEISS: Janet, would you agree with
23 that? Yes, no?

24 MS. McDAVID: I think we should probably move
25 on.

1 MS. SCHULTHEISS: Well, I think the test is
2 important, though, and I think whether you apply the
3 same test or not is an important issue.
4 DR. WARREN-BOULTON: It has a huge effect on the
5 case in question.
6 MS. SCHULTHEISS: And I really would want to
7 know whether you think we should be using a consumer
8 welfare test or a total welfare test regardless of the
9 type of violation you are looking at.
10 MS. McDAVID: Well, I think I started by saying
11 much as Rick did, that the suppliers are entitled to a
12 competitive market just as buyers are, and so I would
13 not exclude a remedy for suppliers by using a test that
14 focused entirely on consumers.
15 MS. SCHULTHEISS: Exclusively.
16 DR. SALOP: Suppose two firms get together and
17 exchange a technology, a labor-saving technology, that
18 enables them to produce the same amount of output with
19 less labor, and as a result of that agreement, the firms
20 demand less labor and the wage rate goes down or some
21 other input, if you will, and suppliers -- here the
22 suppliers of labor are harmed. Do they have standing to
23 bring an antitrust case against that agreement?
24 DR. BRENNAN: No, because total welfare went up.
25 MS. SCHULTHEISS: Jack?

1 DR. WARREN-BOULTON: Total welfare -- I mean --
2 MS. SCHULTHEISS: Let's do this in order. Jack
3 looked like he wanted to respond. Let me let Jack
4 respond first.
5 MR. KIRKWOOD: Yes, that was a point I didn't
6 comment on before, but I do agree with Steve there. If
7 you do have a case in which there is supplier harm but
8 consumer benefit, then I would go with the consumer
9 welfare standard. I think that does make antitrust more
10 coherent.
11 DR. BRENNAN: Total welfare went up in that
12 standard, so I would stick with it.
13 DR. SALOP: Yes. Now, how do you know that
14 total welfare went up? Did you do that calculation?
15 DR. BRENNAN: It is a -- I guess it is a
16 presumption for me, kind of 101, yes.
17 MS. SCHULTHEISS: I mean, I am going to give
18 Rick and Janet one more chance, and then we will get off
19 this.
20 DR. WARREN-BOULTON: How about we get a group of
21 consumers that get together a group of monopsonized
22 consumers, is this somehow a good thing? I don't think
23 so.
24 DR. SALOP: That is the cartel case decided by
25 Judge Breyer at the time, and he said it was okay.

1 DR. WARREN-BOULTON: Well --
2 MS. McDAVID: I think in this -- in the
3 circumstance that Steve has posited, we have got an
4 integrated joint venture that will be evaluated under
5 the rule of reason, there is an efficiency and a
6 business rationale, and under the rule of reason, you
7 probably do not conclude it is illegal.
8 MS. SCHULTHEISS: Well, I want to get to
9 something else that is completely off of this topic for
10 a few minutes, because I want to make sure we have time
11 for it, and that is related to relief and remedies.
12 How do you deal with relief and remedies and in
13 particular in the overbidding situation? Should a court
14 enjoin the defendant's pricing? How do you deal with
15 that issue in the context of this type of conduct?
16 MS. McDAVID: Well, in the private party
17 litigation, it is going to be damages.
18 MS. SCHULTHEISS: I mean in a government case.
19 MS. McDAVID: In a government case, probably --
20 well, then you need to have a standard, and a standard
21 of fairness does not allow a remedy.
22 MS. SCHULTHEISS: But even if you have the
23 Brooke Group standard, what is the Government's remedy
24 in that situation on the predatory bidding, you know,
25 raise your prices or lower your prices? I mean --

1 MS. McDAVID: It is pretty unlikely to me that
2 this is going to be a government case, although I think
3 there is a role for the Government to play in Section 2
4 enforcement, an important role. These cases are going
5 to come up in disputes among rivals.
6 MS. SCHULTHEISS: So, you are thinking the
7 overbidding context, it is not the type of case that the
8 Government should be getting into?
9 MS. McDAVID: It is the type of case that I
10 doubt the Government will get into. It is the type --
11 the Government typically intervenes in cases where there
12 is kind of a broader principle to be generated. This is
13 typically an intrafirm dispute or interfirm dispute, and
14 they rarely get into those circumstances.
15 MS. SCHULTHEISS: Well, when we are looking at
16 what test to apply, though, you know, for example, you
17 know, we did file an amicus brief in this case,
18 obviously concerned with the test and the jury
19 instructions from the Ninth Circuit, if it had been a
20 government case, and I mean this sincerely, what kind of
21 relief could the Government get in any kind of an
22 overbuying monopsony type case like this? Does anybody
23 have any --
24 DR. WARREN-BOULTON: I am about to agree with
25 Janet. I think there are situations in which we rely

1 primarily on deterrents -- there are situations in which
2 deterrents, ex post penalties, are simply much, much
3 less expensive than ex ante penalties. I mean, you
4 think of how would you have hypothetically solved
5 Weyerhaeuser. Well, I suppose to me the answer is you
6 deter basically through either private litigation or a
7 fine. How could you prevent this situation? Would you
8 have to divest? You would have to sort of break up
9 Weyerhaeuser.
10 It seems to me that facing an alternative,
11 looking at the costs of preventing bad behavior through
12 structural means, that is to say, you know, forcing
13 Weyerhaeuser to sell off sawmills versus simply having
14 an ex post, you know, you will face damages if you, you
15 know, behave badly. A behavioral remedy is probably
16 better than a structural remedy, and if it is
17 behavioral, it seems to me I agree with Janet, it is
18 really something -- it is for private litigation.
19 MS. SCHULTHEISS: Would you agree with that,
20 Steve?
21 DR. SALOP: No, I thought -- I think there is an
22 answer. First of all, what the Government usually does
23 is it gets an injunction. You tell them not to violate
24 the standard anymore, and once you know what your
25 standard is --

1 MS. SCHULTHEISS: We have to have a standard,
2 yes.
3 DR. SALOP: -- which hopefully you will know
4 once you bring the case, then you tell them, don't
5 violate the standard.
6 Secondly, I am not sure why Rick was so negative
7 with respect to structural relief. If what Weyerhaeuser
8 did was it knocked its rivals out of business and
9 thereby got a monopsony, then the way to jump-start
10 buy-side competition is to make Weyerhaeuser divest some
11 of its mills to re-establish that competition, or
12 perhaps if Weyerhaeuser simply has one big mill, you
13 would make Weyerhaeuser subsidize the entry of the small
14 sawmills that it knocked out of business. So, there is
15 a potential structural remedy there, or, of course,
16 maybe this would be one of the places where the FTC
17 should seek disgorgement.
18 MS. McDAVID: You see, that is precisely the
19 remedy for private damages. That's what private damages
20 are designed to achieve, is what Steve has just
21 described.
22 DR. WARREN-BOULTON: I agree.
23 DR. BRENNAN: I agree with Steve, and I think
24 Ken said it earlier today, about if you have a
25 structural remedy, that that would be a better thing to

1 do. I think the instance was slots, you know, making
2 that more competitive or something for airports.
3 The one thing that came up in the morning
4 discussion and also here that I honestly do not
5 understand is that somehow that seeking damages is
6 different and that this question only comes up with the
7 Government seeking injunctive relief, because if you
8 have a world where damages are collectible, then people
9 out there have to know what to do to avoid having to pay
10 damages, and the threat of damages in predation cases
11 is, I think, going to involve some kind of, in effect,
12 price regulation that says, you know, if you are bidding
13 now, if you set your price -- if you pay -- and that's
14 in essence the whole problem with the jury instruction,
15 right, that if you pay this much, it's okay, but if you
16 go beyond that, then you are paying too much, and then
17 you are liable to damages, and it is the threat of
18 damages that basically you are going to force people to
19 say, how high a price can I pay and I can't go above
20 that.
21 So, there is something I think inevitable about
22 this kind of law apart from the Government's specific
23 remedies that says that some prices are okay and some
24 prices aren't okay.
25 DR. SALOP: But that is not a lot different than

1 saying you can have exclusive dealing arrangements with
2 six supermarkets but not eight. You talked earlier
3 about the share remedy, so why is one less administrable
4 than the other?
5 DR. BRENNAN: I mean, I think that is a good
6 question. I mean, it's -- you know, we are more
7 comfortable with merger law than we are with price
8 regulation, and maybe we shouldn't be.
9 MS. SCHULTHEISS: Jack?
10 MR. KIRKWOOD: Yes, Pat, your question is
11 excellent, because it forces all of us who are thinking
12 about what standards should be ideal to think about them
13 in the concrete situation where a court might enter an
14 injunction that incorporates the standard, and so if I
15 think a particular standard is appropriate, that would
16 incline me to believe that an injunction that wrote it
17 down would be appropriate, too.
18 I am a little reluctant, for the reason Ken
19 suggested, antitrust normally does not get into direct
20 price regulation, and you would think in the kind of
21 structured rule of reason that Steve and I have been
22 advocating, though with some differences, that there
23 would be more flexibility in the way a court would
24 interpret such a standard in an actual case than the way
25 a court might interpret an order that was written down

1 where someone was seeking contempt sanctions. So, I
2 would be a little reluctant to enter an order here and
3 would want to pay attention to the possibility of
4 structural relief.
5 Weyerhaeuser had six different mills in the
6 area, so it is not inconceivable, and it acquired those
7 mills rather than building them internally.
8 MS. SCHULTHEISS: So, you would envision that it
9 would be possible for the Government to seek relief
10 other than just an injunction?
11 MR. KIRKWOOD: Yes.
12 MS. SCHULTHEISS: Putting aside damages, you
13 know, the DOJ going for treble damages?
14 MR. KIRKWOOD: I mean, the preference, as Janet
15 suggested and Rick, is for --
16 MS. SCHULTHEISS: Deterrence.
17 MR. KIRKWOOD: -- private action.
18 MS. SCHULTHEISS: Rick?
19 DR. WARREN-BOULTON: One little problem, and I
20 think it was echoed by somebody this morning, who said
21 that, you know, the harm to competitors may correlate
22 but is not a very good measure of the harm to either
23 consumers or to producers. In the Ross-Simmons case,
24 the person who is suing for damages is Ross-Simmons,
25 another sawmill. I mean, the whole theory of this is

1 the person who should be suing for damages is the timber
2 owner. I mean, they are the guys who supposedly have
3 been harmed by this, who are being monopsonized.
4 MS. McDAVID: They weren't sure, they were
5 getting a little extra.
6 DR. WARREN-BOULTON: The question is, why do we
7 have the competitor suing rather than the timberer, and
8 the answer is because the competitor gets hurt first,
9 right? Now, we could, of course, simply have said
10 forget it, let's wait, right? But having the competitor
11 sued is a sort of an ex ante, prophylactic way to
12 prevent presumably the monopsony harm to the person you
13 are really worried about, you know, who probably never
14 turned up in this litigation, which was the people who
15 were actually sawing the timber. They are the guys who
16 were supposedly monopsonized.
17 MS. SCHULTHEISS: I am going to ask Ken and
18 Patrick, since they have spent the afternoon with us and
19 have clearly given a lot of thought to these issues, and
20 we talked about it extensively this morning on the
21 sell-side, whether you have any response to the remedies
22 on this side of it, of the issue.
23 DR. ELZINGA: I just have a couple reactions.
24 First of all, I must confess --
25 MS. SCHULTHEISS: Is there a mic near you?

1 MS. McDAVID: First of all, you notice they are
2 sitting closer together.
3 MR. KIRKWOOD: And further away from us.
4 DR. ELZINGA: But you will notice it is I who
5 moved, and I did that as a symbolic gesture in response
6 to what Rick said, and also I moved to my left, which is
7 uncharacteristic for me, as my students would know.
8 Two things: First of all, this has been
9 extremely helpful to me. I didn't realize this whole
10 topic on the buy-side was such a big issue, and that is
11 a reflection perhaps of my being out of a particular
12 loop, but this was a great way to learn about it.
13 I also have rarely seen a group of antitrust
14 experts basically in as much agreement as this group has
15 had. I mean, you can talk about, well, is it consumer
16 welfare or total welfare, and everybody can get into
17 snipping about that, but I thought there was remarkable
18 consensus among the panelists on the topic. So, thanks.
19 Patrick, you are going to have to move down
20 here.
21 MS. SCHULTHEISS: Patrick?
22 DR. WARREN-BOULTON: And now for something
23 completely different.
24 DR. BOLTON: Ken pretty much stole my thunder.
25 I am very much in agreement. Just on the last point

1 about damages, it occurred to me, some of the issues
2 were brought up similar to the case, the
3 Sotheby's-Christie's --
4 MS. SCHULTHEISS: The auction case?
5 DR. BOLTON: -- cartel, yes, where there was an
6 issue who was harmed and how do you -- was it the -- was
7 it the buyers of art or was it the sellers and who
8 should be the recipient of the damages, and in that
9 case, I forget how it was decided in the end, but there
10 was reason to believe that the wrong party was
11 collecting the damages. Maybe someone else will --
12 DR. WARREN-BOULTON: I agree.
13 MS. SCHULTHEISS: Does anybody know?
14 MS. McDAVID: I don't remember who got them.
15 DR. WARREN-BOULTON: Yes.
16 MS. SCHULTHEISS: But it was a damages issue.
17 DR. WARREN-BOULTON: Well, the question was, is
18 if you read the auction -- it is pretty much like the
19 Social Security question, you know, if you pose --
20 Social Security taxes, who pays it, is it labor or is it
21 the firm? If you ask anybody on the street, they say,
22 oh, I pay half of it and my employer pays half of it.
23 If you ask an economist, and he will say 95 percent is
24 paid for by the workers, but the incidence of a tax
25 bears very little resemblance to the accounting and

1 collection of that tax, and I think in the same way, it
2 is extraordinarily difficult to find out who actually
3 pays for antitrust violations by simply looking at the
4 accounting incidence.
5 DR. SALOP: Yes, I --
6 MS. SCHULTHEISS: We have two minutes.
7 DR. SALOP: Okay, so I will just make a law
8 professor remark. There is Illinois Brick and there is
9 Hanover Shoe, and that says the direct purchasers get to
10 sue the direct purchasers or sellers of the art. They
11 get the money. There is no pass-on defense by the
12 cartel, and the -- you know, the Supreme Court had a
13 reason for that, and so the -- I would think the proper
14 people to get the money under the current law are the
15 sellers of the art, not the buyers.
16 MS. SCHULTHEISS: Okay. Well, I think with
17 that --
18 DR. ELZINGA: I worked for the judge on that
19 case. Most of it went to the lawyers.
20 MS. SCHULTHEISS: Well, on that note --
21 MS. McDAVID: The entrepreneurial plaintiff's
22 bar.
23 DR. WARREN-BOULTON: Well, at least some of it
24 went to you.
25 MS. SCHULTHEISS: On that note, we will wrap

1 this session up, and I ask you to join me in giving a
2 hand to our panelists. Thank you very much.
3 (Applause.)
4 (Whereupon, at 3:58 p.m., the hearing was
5 concluded.)
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