



presents

Antitrust Enforcement for Single Firm Conduct: Sweeping Changes Under Way

New Strategies for Complying With Section 2 of the Sherman Act

A Live 90-Minute Audio Conference with Interactive Q&A

Today's panel features:

Janet L. McDavid, Partner, **Hogan & Hartson**, Washington, D.C.

Deborah A. Garza, Partner, **Covington & Burling**, Washington, D.C.

Marc G. Schildkraut, Partner, **Howrey**, Washington, D.C.

Steven C. Salop, Senior Consultant, **CRA International**, Washington, D.C.

Thursday, August 6, 2009

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U.S. Monopolization Law

Recent Developments

Janet L. McDavid

Hogan & Hartson LLP

July 2009



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Section 2 of the Sherman Act



John Sherman

- Section 2 prohibits monopolization and attempted monopolization.
 - Monopolization requires both the possession of monopoly power and the willful acquisition or maintenance of monopoly power.
 - Attempted monopolizations adds a requirement of a dangerous probability of successful monopolization.
- Section 2 does not prohibit the possession of monopoly power standing alone – it also requires anticompetitive or exclusionary conduct.
- U.S. law recognizes the difficulty of distinguishing lawful competition by dominant firms from unlawful exclusionary conduct.
- There is no single standard for defining exclusionary conduct in the US.
 - Section 2 cases require substantial evidence of anticompetitive intent.

Recent U.S. Section 2 Activity

- **The Bush Administration DOJ issued Section 2 Report** following joint FTC/DOJ hearings on the appropriate standards for Section 2 enforcement; three FTC Commissioners criticized DOJ Report.
- **New Obama AAG Varney withdrew the Section 2 Report.**
- The D.C. Circuit overturned the FTC's unanimous decision that **Rambus** violated Section 2 through deception in standard setting, and the Supreme Court denied review.
- Over the protests of the DOJ and Microsoft, the **Microsoft** consent decree has been extended two years until November 2009.
- The Supreme Court decided **Trinko** in 2004, **Weyerhaeuser** in 2007, and **linkLine v. SBC** this term.
- The Third and Ninth Circuits decided bundling cases using different standards: **LePage's** and **PeaceHealth**.
- The **Antitrust Modernization Commission** evaluated the standards for Section 2 liability and also recommended a test for bundled discounts.

Microsoft: The Never Ending Story

- In 2001, the Justice Department won its Section 2 case against Microsoft.
 - The court held that Microsoft's restrictions on original equipment manufacturers; its bundling of Internet Explorer into Windows; its dealings with internet access providers, independent software vendors, and Apple Computer; and its efforts to contain and to subvert Java technologies that threatened Microsoft's operating system monopoly, all served unlawfully to maintain the Windows desktop operating system monopoly.
- In 2002, the Justice Department and Microsoft entered into a consent decree that required disclosures to allow interoperability.
- The consent decree was due to expire in November 2007, but, at the request of 11 states, a federal judge extended the decree by two years in January 2008 over the objections of both DOJ and Microsoft.
 - DOJ notably opposed an extension, arguing that the consent decree should be allowed to expire because it had achieved its intended purpose.
- Microsoft just made a proposal to resolve a long-pending EU dominant firm investigation.



Trinko and Refusals to Deal

- The Supreme Court held that Verizon's breach of a duty to share its local telephone network with its competitors as required by the Telecommunications Act of 1996 does not support a claim for liability under Section 2 of the Sherman Act
- The decision established several basic principles
 - In general, a monopolist has no general duty to aid its competitors
 - There are grave doubts about the viability of the essential facilities doctrine in the U.S.
 - Termination of a prior business relationship may be key to liability
 - Sacrifice of short term profits may be sufficient . . .but not necessary
 - *Trinko* is limited to Section 2 claims involving refusals to deal and does not apply to other kinds of monopolization
 - But *Trinko* may signal broader hostility to Section 2 claims

Weyerhaeuser:

Testing the Water for Predatory Purchasing

- In *Brooke Group v. Brown & Williamson Tobacco* (1993), the Supreme Court established a rule for predatory pricing. Liability exists when the defendant:
 - Prices below some measure of cost, and
 - Has a dangerous probability of recouping its short term losses through supracompetitive prices.
- The question for lower courts is whether to apply this test to other types of Section 2 conduct.
- In *Weyerhaeuser* (2007), the Supreme Court overturned the Ninth Circuit’s decision that Weyerhaeuser had violated Section 2 through “predatory purchasing.”
 - The Ninth Circuit had held that a firm could violate Section 2 if it purchased more inputs than it needed at a price that was “higher than necessary” to prevent rivals from obtaining inputs at a “fair price.”
 - The Supreme Court opted instead to apply the *Brooke Group* predatory pricing standard to predatory purchasing.



linkLine v. SBC:

Price Squeezes Are Not Generally Actionable



- The U.S. Supreme Court barred price-squeeze claims where the defendant has no clear duty to deal with its competitors. .
 - Under the Telecommunications Act of 1996, SBC is required to sell wholesale DSL service to internet service providers like linkLine, which resells DSL in competition with SBC.
 - Plaintiff alleged that SBC’s high wholesale price relative to its retail price created an anticompetitive price squeeze, i.e. that linkLike could not sell in competition with SBC because the wholesale prices it paid to SBC left little margin.
- Chief Justice Roberts wrote that *Trinko* was controlling: “The plaintiffs alleged that the defendants (upstream monopolists) abused their power in the wholesale market to prevent rival firms from competing effectively in the retail market. *Trinko* holds that such claims are not cognizable under the Sherman Act in the absence of an antitrust duty to deal.”
- “The reasoning of *Trinko* applies with equal force to price-squeeze claims.”

LePage's and *PeaceHealth*: Bundling – Who Needs a Consistent Test?

- In *LePage's* (2003), the Third Circuit upheld a \$68.4 million verdict against 3M based on bundled discounts.
 - Rejecting the *Brooke Group* test, the court found liability even though 3M's prices were above cost.
 - The court used a presumption that bundled discounts are exclusionary if the discounter:
 - 1) has market power, 2) is bundling products not sold by rivals, and 3) is winning business from those rivals.
 - The presumption can be rebutted if the discounter proves a “business reasons justification” for the bundled discounts.
- In *PeaceHealth* (2007), the Ninth Circuit rejected *LePage's* analysis and instead used a test consistent with *Brooke Group*. According to the Ninth Circuit test, liability exists only if --
 - After allocating all discounts and rebates of the entire bundle to the competitive product, the price of the competitive product is below its incremental cost.



Antitrust Modernization Commission: Wanted: 21st Century Law for 21st Century Problems

- Congress established the AMC “to examine whether the need exists to modernize the antitrust laws and to identify and study related issues.” In April 2007, the AMC published its findings and recommendations, including several related to Section 2.
- The AMC stressed the importance of clear standards with predictable application.
 - It reviewed the various tests used under Section 2 (e.g, profit sacrifice, no economic sense, balancing, less efficient competitor), but did not reach a consensus on which test could be effective across Section 2 cases. Consequently, the AMC called for continued development by courts, commentators, and agencies.
- The AMC findings suggested that bundled discounts analysis should use a 3 part test that analyzes whether:
 - 1) after allocating all discounts on the bundle to the competitive product, the discounted price of the competitive product was below its incremental cost;
 - 2) the defendant is likely to recoup these short term losses; and
 - 3) the program is likely to have an adverse effect on competition.
- Unilateral refusals to deal: firms generally have no duty to deal with a rival in the same market.
 - The Commission did not endorse any single test for when a monopolist may be liable for refusal to deal.



Exporting U.S. Antitrust Philosophy: Even With a Weak \$, Will Anyone Buy It?

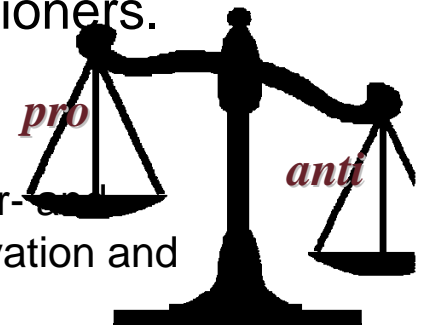
- In 2005, the U.S. antitrust agencies participated with the European Commission in an EC Discussion Paper on abuse of dominance.
 - The U.S. participation was behind closed doors rather public settings.
- U.S. agencies have publicly confronted the EU less frequently in recent years than they have in the past, but some confrontation still occurs:
 - DOJ commented in 2006 that the EU's Microsoft order had resulted in more effective disclosures by Microsoft than DOJ had previously achieved.
 - But in late 2007, DOJ sharply criticized the European Court of First Instance's refusal to overturn an EC ruling that ordered Microsoft to disclose code necessary to interoperate, unbundle its Media Player, and pay a \$600 million fine.



DRIVING THE U.S. ECONOMY

DOJ Report on Section 2: Going It Alone

- DOJ and FTC held joint hearings, including 29 panels that included academics, business people, and antitrust practitioners.
- DOJ subsequently issued a report – without the FTC.
 - Standards should be predictable and strike a balance between over- and under-deterrence – with false positives and the risk of chilling innovation and vigorous competition being the clearly greater concern.
 - In the absence of a conduct specific test (like the *Brooke Group* test for predatory pricing discussed above) or safe harbor, the DOJ recommended a disproportionality test.
 - Weigh the procompetitive and anticompetitive effects of challenged conduct - liability attaches if the anticompetitive effects substantially outweigh the procompetitive effects.
 - DOJ did not identify a specific tipping point but stated that if the harms and benefits were close to comparable, DOJ would not challenge it.
- DOJ did not bring a Section 2 case for 8 years during the Bush Administration.



FTC Enforcement of Section 2

- In contrast to DOJ, FTC has brought several Section 2 cases in recent years
 - Significant settlement in *Unocal* standard setting case
 - The FTC ruled unanimously that *Rambus* violated Section 2 through deception in standard setting.
 - The DC Circuit reversed that decision and the Supreme Court denied review
 - The FTC has announced its interest in continuing to pursue those issues despite the loss in *Rambus*

Section 2 in the Obama Administration

- The Obama campaign antitrust statement said it would “reinvigorate efforts to identify and take action against illegal monopolies”
- In her first speech as Assistant Attorney General, Christine Varney withdrew the Bush Administration’s Section Report.
 - “It raised many hurdles to Government antitrust enforcement.”
 - “The Report . . . went too far in evaluating the importance of preserving possible efficiencies and understated the importance of redressing exclusionary and predatory acts that result in harm to competition, distort markets, and increase barriers to entry.”
 - “The Department is committed to aggressively pursuing enforcement of Section 2 of the Sherman Act in furtherance of the principles embodied in [*Lorain Journal, Aspen, and Microsoft*].”
 - “I strongly believe that antitrust enforcers are able to separate the wheat from the chaff in identifying exclusionary and predatory acts.”
- DOJ and FTC Section 2 enforcement is likely to be more aligned in the Obama Administration than it was during the Bush Administration



Janet L. McDavid
Partner,
Washington, D.C.

jlmcdavid@hhlaw.com
Phone: +1.202.637.8780
Fax: +1.202.637.5910

Janet McDavid focuses on antitrust, competition, and trade regulation, with a particular emphasis on government investigations, litigation, and antitrust policy issues.

Jan has been profiled in numerous international surveys and rankings and is widely recognized as a leading authority in antitrust law. Most recently, she was named as "one of the finest antitrust lawyers around" and lauded for her "... very good judgment and practical advice," by *Who's Who Legal*. Other industry authorities, such as *Chambers USA*, have noted client praise for her strong ties to the government: "In terms of working with the agencies, she is terrific." Clients say Jan "understands how business people operate" and describe her as "the cream of the crop" with "one of the best reputations at the antitrust bar." Jan is also a frequent speaker on antitrust issues around the globe.

Jan is the author and co-author of many books and articles involving antitrust law, including the *Antitrust Evidence Handbook*, *Mergers & Acquisitions* and *Antitrust & Trade Associations Practice Guide*, both published by the ABA Antitrust Section; *Proposed Reform of the EU Merger Regulation: A U.S. Perspective*; *Merger Review Processes in the United States and the European Union: A Comparison*; *How to Avoid Negotiations on Second Requests*; *Globalization and the EU*; *Globalization of Premerger Notification and Review: Practical Problems and Solutions*; *Antitrust Law: Intersection with IP*; *Antitrust and IP: Joint Agency Hearings*; *The Defense of Mergers in the Defense Industry*; *Antitrust Issues in Health Care Reform*; and *The 1992 Horizontal Merger Guidelines: A Practitioner's View of Key Issues in Defending a Merger*.

Jan is a Past Chair of the Section of Antitrust Law of the American Bar Association. She was a member of the Advisory Team to the Transition Team for the Federal Trade Commission for Obama Administration in 2008 and for the Bush Administration in 2001, and was a member of the Transition Team for the FTC for the Clinton Administration in 1992. She also served as Co-Chair of the ABA Antitrust Section's Transition Task Force, which provided advice on antitrust issues to the Obama Administration. In 1993-94 and 1996-97, she was a member of Department of Defense Antitrust Task Forces.

EDUCATION

J.D., Georgetown University Law Center, 1974

B.A., Northwestern University, 1971

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Monopolization Law: Pricing, Price Squeezes, and Bundling

Marc G. Schildkraut
August 6, 2009

HOWREY_{LLP}

> Antitrust > Global Litigation > Intellectual Property

A General Trend in Monopoly Law

- There has been a trend, with many bumps in the road and some reverses, to distill many—not all—monopolization claims down to pricing conduct.
- Two principles are employed where the distillation has remained true to form:
 - A monopolist can charge as high a price as it wants unless it has a duty to deal.
 - A monopolist can charge as low a price as it wants so long as it does not set prices below some measure of cost.
- Courts have applied these principles to predatory pricing, price squeezes, loyalty rebates, bundling and similar conduct.
- Even when these principles have been applied, there are many questions that must be addressed:
 - What is the appropriate measure of costs?
 - How do we apply the rules to conduct that is something more than a simple price quote?

Are High Prices Ever Unlawful?

- In *Aspen*, the Supreme Court found that there were circumstances where a monopolist must deal with its rival.
- While not a focus of the Court's opinion, the monopolist wanted a bigger cut of a joint ski lift ticket that it marketed with its rival.
 - So the real dispute was over the price. The refusal to deal meant only that the monopolist refused to offer the rival a cut that the rival would accept.
 - This would seem to be totally symmetric: the rival refused to deal with the monopolist unless the rival's demand for a larger cut was met.
- So *Aspen* seems to stand for the proposition that the Sherman Act may fetter a monopolist's price.

Are High Prices Ever Unlawful?

- *Trinko*:
 - In *Trinko*, the Supreme Court appeared to hold that there was no limit on the price that a monopolist could charge, except perhaps where a monopolist has a duty to deal with a competitor.
 - In *Trinko*, the Court held that the defendant had no duty to deal.
 - While the exact limits of *Trinko* are far from clear, many believe that the essential facility doctrine and the concomitant duty to deal is on life support.
 - If there is any remaining duty to deal, the Court certainly offered no guidance as to when a monopolist's price is so high it amounts to a refusal to deal.

Are High Prices Ever Unlawful?

- The next chapter in the saga is *Linkline*.
- The plaintiffs alleged that they were facing a price squeeze: prices too high at wholesale and too low at retail for the plaintiffs to make a reasonable profit.
- Because there was no claim that the defendant had a duty to deal, the defendant was free to charge whatever wholesale price it wished, according to the Court.
- Because there was no allegation that the retail price was below cost, the supposed price squeeze did not violate the antitrust laws.
- The Court concluded that a monopolist is not required to price its products in a manner that gives its rivals a fair profit.

When are prices too high?

- *Discon*
 - A lawful monopoly provider of local telephone services, charged its customers higher prices as a result of alleged fraudulent rebate conduct.
 - Plaintiff refused to play the rebate game with the monopolist and was eliminated from the market as a result.
 - The Supreme Court found no violation of the antitrust laws.
 - Consumers may have been harmed by paying higher prices.
 - But the consumer injury flowed not from a less competitive market but from the exercise of market power that was lawfully in the hands of a monopolist.
- The antitrust laws, it seems, are not designed to prevent higher prices, only to prevent the reduction in rivalry that results in higher prices.

When are prices too high?

- *Rambus*: patent holder was alleged to have failed to inform a standard setting organization that it had a patent that read on the standard.
 - The FTC found a violation, concluding that had Rambus fully disclosed its IP:
 - The standard setter would have excluded Rambus's technology from the standard, *or*
 - Would have demanded and received assurances of reasonable pricing.
 - The Court of Appeals reversed:
 - If Rambus's disclosure would have caused JEDEC to adopt a different, open, non-proprietary standard, the failure to disclose could have supported a monopolization claim.
 - But if Rambus's disclosure would have resulted in the adoption of Rambus's technology under RAND terms, there would be no viable monopoly claim because
 - There would still be a monopolist.
 - The only difference would be a lower price charged by that monopolist.
 - Because the FTC could not say which of the two outcomes would occur, there was no viable monopoly claim.

When are prices too high?

- *N-Data*: a bump in the road or a different direction?
 - National Semiconductor promised a standard setting organization it would only charge a \$1000 licensing fee if its technology were adopted.
 - N-Data acquired the patents covering the technology from National Semiconductor after the technology was adopted.
 - N-Data did not honor National Semiconductor's promise.
 - The FTC found that N-Data had violated Section 5 of the FTC Act because N-Data's licensing policies threatened to increase the cost of practicing the standard.
- But was there any reduction in competition?
- Are all exploitative prices potential violations of FTC 5?

When are prices too high?

Ovation

- The FTC filed suit against Ovation's acquisition of NeoProfen, a drug used to treat infant heart conditions.
- Ovation had previously acquired a competing pharmaceutical, Indocin, from Merck.
- There was nothing novel in this FTC challenge.
- However, then Commissioner Leibowitz and Commissioner Rosch issued a concurring statement, arguing in favor of challenging Ovation's acquisition of Indocin as well.
 - After Ovation acquired Indocin, it raised the price 1300 percent.
 - Perhaps Merck had charged lower prices to protect its reputation.
- But how did the first acquisition lessen competition?

When are prices too low?

- In *Brooke Group* and *Linkline*, the Supreme Court held that prices are not predatory and unlawful if they are above some measure of cost.
- The Court did not tell us what was the appropriate measure of cost.
- The Court applied the same logic to predatory buying in *Weyerhaeuser* and came to the same conclusion, offering these additional thoughts on predatory pricing:
 - The requirement that prices be below the monopolist's costs was necessary because condemning above-cost pricing would punish a firm with a low cost structure and require analysis that was beyond courts' ability.
 - Proof of recoupment was also necessary because a firm was unlikely to predate unless it could recoup.
 - The court also noted that price cutting was the essence of competition, making it hard to distinguish proper from improper behavior.

When are prices too low?

- Price standards
 - Areeda-Turner test: price below average variable cost (AVC)
 - Most courts of appeal that have addressed the issue have adopted some variant of the Areeda-Turner test.
 - The FTC in *ITT*, concluded that prices below AVC should be presumed anticompetitive. Prices above AVC should be presumed legal.
 - The recently withdrawn Antitrust Division monopoly report adopted an average avoidable cost standard (AAC).
 - AVC plus fixed costs incurred to generate the incremental predatory output.

When are prices too low?

- Three FTC Commissioners rejected the AAC standard in the DOJ report because AAC pricing could exclude rivals where upfront investment was high and variable costs were low.
- The FTC did not propose an alternative. But the standard adopted by the EU may give us some clues about the FTC thinking.
- The EU adopts two standards:
 - AAC
 - Long run average incremental costs (LRAIC)
 - Long-run average incremental cost is the average of all the (variable and fixed) costs that a company incurs to produce a particular product. LRAIC and average total cost are good proxies for each other.

When are prices too low?

- LRAIC
 - The EU never explains how to allocate the investment across multiple products and multiple periods.
 - How do you allocate an R&D investment that is incorporated in many product generations?
 - Consider the implications of LRAIC during a recession?
 - A monopolist wishes to lower its price to keep its factories filled, its workers employed and to pay something towards fixed overhead.
 - Are they barred from increasing output and keeping people employed by the LRAIC standard?

Bundling and Predatory Pricing

- In bundling or package pricing, the seller offers the bundle at a lower price than it offers the individual components.
- The DOJ monopoly report offered two tests of bundling:
 - If the aggrieved rival could offer all the products in the bundle, the conduct would be evaluated under a standard predatory pricing analysis.
 - If the competitor could not offer all products, the entire discount in the bundle would be attributed to the product in the monopolist's bundle that competes with the rival's product. The DOJ would then evaluate whether this attributed price is below cost.
- This methodology is similar to that used by the Ninth Circuit in *PeaceHealth*.
- This contrasts with the Third Circuit approach in *LePage's* where the court let the jury to determine whether the bundled price foreclosed competition.

Bundling and Predatory Pricing

- The Commission majority criticized the standard in the DOJ report and by implication in *PeaceHealth*, arguing that the Supreme Court has never approved of the use of the predatory pricing standard beyond single product pricing.
- The Commission suggested that exclusive dealing analysis might be applicable to bundling.
- But the Commission offered no guidance as to how this analysis ought to be applied in the absence of a price-cost test.
 - Why would the bundle be exclusionary if an equally efficient competitor could match the price of the components of the bundle and still be pricing above its costs?

Predatory Pricing, Bundling and Other Exclusionary Conduct

- In her very first speech as Assistant Attorney General for Antitrust, Christine Varney withdrew the the DOJ's monopoly report.
- One hopes that a new report will be issued with new guidance on monopoly conduct.
- Until then, Ms. Varney suggested we rely on tried and true Supreme Court precedents to evaluate exclusionary conduct.
- She did not mention a single monopoly case decided by the Supreme Court during the last eight years.



Notes on Section 2 Enforcement Issues

Steven C. Salop
Georgetown University Law Center
Charles River Associates

*Not for Quotation
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ABA Section 2 TeleSeminar (August 6, 2009)



Introduction

- I want to follow up on Marc's comments and discuss 3 issues, if there is time.
 - Loyalty discounts.
 - Refusals to deal/price squeezes
 - Rambus

A. Refusals to Deal and Price Squeezes

- DOJ will need to be active in this area
- Refusals to deal by vertically integrated monopolists can lead to substantial anticompetitive effects
- The Supreme Court's dicta in *Trinko* and *Linkline* also raise dangers for other areas of antitrust beyond refusals to deal and price squeezes
- Two main sources of risk:
 - #1 – Belief that monopolists need protection from entrants
 - #2 - Belief that price/cost standards are not administrable by courts

What is at Risk: Monopolist Worship



- The view that monopolists need to be coddled in order to encourage innovation and “business acumen”— is very dangerous for the economy and antitrust law.
 - I could imagine a post-Trinko court enamored with Judge Posner rejecting a plaintiff's claim solely because it is less efficient than the entrant. *Could this become a new threshold test?*
 - Of course, this test would make no economic sense. Destroying a less efficient entrant generally leads to higher prices and consumer harm.
 - I’m concerned that the views expressed in Trinko and other cases will lead to narrowing of Section 2 and enforcement against other conduct that might be considered an “abuse of monopoly power,” like tying, bundled discounts, and exclusive dealing agreements
- I do not think that new DOJ views Section 2 as a “monopolist protection” statute. So I expect pushback here.

What is at Risk:

Disrespect for Judicial Competence

- The view in *Linkline* that courts cannot competently administer a refusal to deal/price squeeze rule also could be used to attack claims regarding bundled rebates, exclusivity/loyalty discounts. Thus, it is dangerous for antitrust enforcement
- In fact, it even can be used to attack predatory pricing claims.
 - If courts can compare prices to costs in *Brooke Group*, then they can administer a similar standard for RTD and P-squeezes too.
 - As discussed below, benchmark standards for RTD and P-squeezes often involve merely a comparison of monopolist's price and cost.
 - If not, then even predatory pricing enforcement is at risk
 - Court cannot have it both ways.
- In this sense, *Linkline* rejects *Brooke Group* even as it embraces it.
 - Not quite the Godfather's "kiss of death." -- at least not yet

Refusals to Deal: Protected Profits Benchmark (PPB)

- In several articles, I have proposed a price benchmark to apply to RTD and price squeezes by vertically integrated monopolists
 - Standard builds on the “ECPR” used in regulation, as applied to antitrust
- If competitor sells a product in downstream output market but must rely on then monopolist for the input, then the plaintiff would need to show that the monopolist's input price is above the PPB price.
 - For homogenous products, the PPB involves information only on monopolist's prices and costs
 - For differentiated products, the PPB also uses the degree of substitution between the product of monopolist and the competitor – e.g., monopolist’s market share as a proxy
 - If monopolist’s wholesale price > retail price, then the PPB standard clearly would be failed, at least if dealing with outsiders is feasible and lacks free rider and other problems.
- LL Court appears to reject this approach, even as it embraces *Brooke Group*.

B. Loyalty Discounts

Disclaimer – Intel is a client of mine. My remarks here are mine, not Intel's. In fact, in this educational seminar, my remarks will not necessarily represent my own opinions but rather are intended to stimulate discussion.

- Loyalty discounts (LDs) likely will be an issue for DOJ and FTC
 - LD rules relate to bundled discounts, which will become an even more important issue as per se tying rule is weakened or eliminated.
 - LD cases also are a way of reining-in *Brooke Group* (or preventing expansion -- creeping Brookism)
 - Action in EU and elsewhere will create additional pressure
- Agencies will need to define a rule of reason liability standard for LDs
- Two prongs to ROR liability analysis (aside from market power)
 - #1- Price/Cost comparison
 - #2 -Recoupment/Consumer Harm
 - Note: recoupment may be a *rough* proxy for consumer harm or involve similar evidence. I will combine them here.
- There are several issues with respect to each prong

Effective Price < Cost Comparison

- Relevance of $EP < Cost$ showing
 - Evidence of profit-sacrifice
 - Also relates to “equally efficient competitor” standard
- Relevant Measure of Cost
 - Marc S. has discussed already
 - Same issues as *Brooke Group*
 - But, applied here to incremental cost relevant to discounts over the relevant range of output
 - LRAIC, more like ATC
 - $SRAIC = AAC = AVC$
 - Both could be relevant
 - E.g., require more evidence of harm if $ATC > EP > AAC$ than if $P < AAC$

The Effective Price Test: Is Effective Price < Cost ?

Calculating "Effective Price: Easy to explain with concepts of "contestable volume" and "conditional discount"

- Suppose that Defendant has a normal price of \$100, and it offers a "lump sum" discount of \$200 "conditional" on a customer purchasing at least 90 units from the defendant. Suppose that absent the conditional discount, the customer would have bought only 80 units, that is, 10 units less.
- The "conditional discount" is \$200
- The "contestable volume" is 10 units.
- Effective price here is \$80
 - Conditional discount is \$20 per unit, if spread over the 10 incremental units
 - So, effective price is $\$100 - \$20 = \$80$
 - \$80 effective price could be compared to the relevant cost measure.
- Framework can be applied to "first-dollar" discounts as well.
 - Instead of lump-sum, suppose seller offers customer a discount price of \$95 on all units, *if customer buys 90 units instead of 80 units*.
 - "First Dollar Discount" concept: get the \$5 discount on all 90 units, not just the 10 extra.
 - Here, Effective Price is $\$55 = \$95 - \$40$
 - \$95 discounted price per unit on the 10 "contestable" (ie incremental) units
 - Less: the \$400 "rebate" on the first 80 units, spread over the 10 units, or \$40 each.



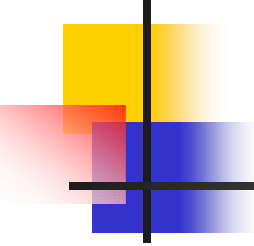
Estimating Effective Price

- Simple calculation in principle – but raises several knotty practical problems
 - Especially if there is not a standard price list for all customers, but instead individually negotiated contracts
- Examples
 - **Whose perceptions of contestable volume, seller or buyer?**
 - Buyer's documents may suggest that CV is very low, but buyer may tell seller that CV is high, as bluff to negotiate a lower price. Makes more sense to me to use seller's expectations, assuming that they are reasonable/credible.
 - **What fraction of total discount is conditional?**
 - Easy if seller offers identical standard schedule to all customers.
 - But, what if individualized negotiations?
 - What if seller tends to give unequal discounts off list price to various customers at different points in time?
 - Then, raises knotty measurement issue
 - **Measuring whether the discount affects conduct?**
 - Suppose that first dollar discount kicks in if $Q \geq 90$ units. But, what if buyer actually would have purchased 91 units even absent the first dollar discount (ie at \$100), and 100 units if discount?
 - Here, the “conditionality” of discount has no effect on purchases. It was the reduction in price on incremental units down to \$95 that increased sales.
 - Thus, the conditional discount should be viewed as zero for this customer.



Beyond Price/Cost Comparison: Other Rule of Reason Evidence

- Recoupment/Consumer harm evidence also is relevant under the rule of reason
 - Foreclosed Sales
 - Consumer Harm: Likely Price Effects
- **Foreclosed sales (FS)**
 - Even if $EP < C$, there may not be anticompetitive effects
 - E.g., if CD is offered to one small customer, then likely no anticompetitive effect
 - E.g., if CD is offered to all customers, but it moves the sales of only one small customers, then similarly no likely anticompetitive effect
 - Need to estimate the total sales volume foreclosed by the CDs
 - Some relevant Comparisons:
 - Is this magnitude of FS likely to drive competitor below MVS or raise its variable costs?
 - Is this magnitude of FS Likely to cause competitor to stop/substantially reduce investing?



Other Rule of Reason Evidence (Continued)

- **Likely Price Effects/Consumer Harm**
 - Focus should be on consumer welfare.
 - Did CDs lead to exit?
 - Can it be shown that CDs led to higher prices (net of discounts)
 - Or, did CDs lead to lower prices as defendant and competitor cut prices?
- **Price benchmark issue**
 - Arises in several ways
 - CD theory assumes that the seller offered “real discounts.” May not be true.
 - Questions:
 - Did the seller raise “normal” prices in anticipation of offering CDs? If so, then “Sham” discounts?
 - Would seller have offered unconditional discounts, if its CDs were not permitted by antitrust law?



C. Rambus

- DC Circuit seemed to be saying that the FTC would have to show that the SSO would have chosen a different standard if Rambus had disclosed.
 - Court seems to suggest that it would have been insufficient merely to show that the SSO could have negotiated a lower price from Rambus.
- **This makes no economic sense. If a firm engages in inefficient conduct that prevents competition from occurring and can charge a higher price as a result, then that conduct leads to monopoly power and harms consumers.**
 - A higher Rambus percentage royalty likely would lead to reduced output too.
 - In this sense, the court seemed to ignore the learning of *Microsoft*
- **Applying this approach to other simple hypothetical cases shows its bizarre implications.**
 - Suppose a monopolist's ability to charge a price all the way up to the full monopoly level is constrained to some degree by a less efficient entrant that it has to outbid.
 - Suppose the entrant doesn't get any sales; suppose it merely constrains the monopolist by being a "perceived potential entrant."
 - Now, suppose that the monopolist kills the potential entrant, say by blowing up its factory, etc.
 - As a result, the monopolist is able to raise price, since the constraint is gone.
 - Under *Rambus*, it would appear that this conduct would **not** violate section 2.
- As part of its analysis, the court claims it is relying on *Discon*.
 - But, it seemed to ignore the fact that the analysis of *Discon* revolved around the fact that NYTel was regulated, so that its conduct was an "evasion of regulation" that was the proper responsibility of the regulators, not an antitrust court.
 - That is, the DC Circuit apparently even ignored the central learning of *Trinko*.

Resolving & Reducing Rambus

- I think that the DC Circuit – and Judge Williams – are smart and know antitrust.
 - They did write the *Microsoft* opinion.
 - I think that they were really focusing on the fact that the FTC did not provide sufficient evidence that Rambus lacked lawful ex ante monopoly power.
 - That lack of evidence is what the case really stands for.
- Let me explain:
 - Suppose Rambus had disclosed, but suppose that there were no good substitutes, so that Rambus still would have been selected and still would have been able to negotiate the full monopoly price
 - **In that situation, alleged deception would have no price effects at all.**
 - **Thus, unless FTC could rule out such ex ante monopoly power, then FTC failed to show that deception contributed to Rambus monopoly power**
- FTC did not show that Rambus lacked lawful ex ante monopoly power.
 - FTC simply put the burden of proof on Rambus
- Thus, FTC failed to show that Rambus' conduct affected either the standard or the price that would have been negotiated had Rambus disclosed. That is the FTC's failure of proof.
- Of course, this interpretation means that the opinion is not really dangerous, once it is explained and appropriately limited