Federal Trade Commission

I say Monopoly, You say Dominance:
The Continuing Divide on the Treatment of Dominant Firms, is it the Economics?

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I. INTRODUCTION

With the issuance of the Statement of Objections to Intel and on the eve of the much-anticipated decision in the Microsoft saga here in Europe, it seems timely to discuss the differences in the United States and in Europe in the interpretation and application of competition laws to dominant firms. I spent a good part of my career advising – and litigating on behalf of – allegedly dominant firms. However, a Commissioner has the luxury of thinking about the forest rather than simply the trees. So I have spent a fair amount of time over the last year musing about the differences in competition policy and jurisprudence in the United States and Europe. I have also given some thought to where the law might be headed in both jurisdictions.

In the United States, a number of recent appellate decisions, including the Supreme Court's decisions in *Trinko* and *Weyerhaeuser*, have indicated where our monopolization law is

[1] The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisor, Kyle Andeer, for his invaluable assistance in preparing this paper.

In the past year, I have suggested several factors that may contribute to our continuing differences with respect to the treatment of dominant firms.[7] One factor is the high cost of antitrust litigation in American courts, due to the opportunity for private enforcement of the

Chicago School economics. Meanwhile, our European colleagues seem to have embraced a different school of economic thinking. Many of the theories underlying the Commission's recent Article 82 cases are grounded in what is often referred to as post-Chicago School economics. Indeed, post-Chicago theories also appear to play an important role in DG Competition's

as the Chicago School. The Chicago School began as an economic critique of the interventionist antitrust jurisprudence of the mid-twentieth century and the rules of *per se* illegality governing a variety of conduct.[18] Its early adherents demonstrated that the assumptions underlying the *per se* rules of that era were unsound and sought to ground antitrust law in price theory and efficiencies. The assumptions underlying tying, resale price maintenance, and predatory pricing claims were the early targets for criticism.[19]

Chicago School adherents then extended their analysis to question theories supporting challenges to a variety of other practices. They urged a much more cautious approach to antitrust law enforcement generally. For example, then Professor (now Judge) Easterbrook wrote that it would be hard to compile a list of ten cases in the history of antitrust that should have been allowed to go to trial.[20] Then Professor (now Judge) Posner wrote that the focus of the antitrust laws should be limited to (1) cartels and (2) horizontal mergers large enough to create monopoly power or to facilitate cartelization.[21]

Underpinning these views about the proper limits of antitrust law enforcement was a series of interrelated assumptions and conclusions. The core assumption was that antitrust is – or at least ought to be – concerned solely about allocative and production inefficiencies that may pose a threat to the maximization of society's wealth. Perhaps Judge Bork best summed up this view when he wrote that "[t]he whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so as to produce either no gain or a net loss in consumer welfare."[22] A second assumption was reflected in Judge Posner's rhetorical questions about why a firm would engage in tying or leveraging. Chicago School adherents considered predatory conduct generally to be irrational, and they therefore considered it unlikely that firms – even dominant firms – would engage in it.[23] A third assumption was that even when a firm does not behave rationally and tries to engage in predatory conduct, the market is likely to correct itself so that antitrust law enforcement is generally unnecessary and wasteful.[24]

Those assumptions led to two conclusions. The first conclusion, derived from the assumption that firms act rationally and therefore rarely engage in predatory conduct, was that firms alleged to be engaging in such conduct were more likely to be engaging in profit-

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21 Richard Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L.REV. 925 (1979).

22 BORK, THE ANTITRUST PARADOX at 9.

23 See Posner, 127 U. PA. L.REV. at 928.

24 See Posner, 127 U. PA. L.REV. 925; see also Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. cEMdorMCIh0 7.noThe ly unneTon 0 0c 0 .0 T41 Tm(22)TjEArtift, w(SAttach en[/

maximizing conduct that was efficiency-enhancing instead of efficiency-impairing in nature. The second conclusion, derived from the assumption that even if a firm were to try to engage in predatory conduct the market would likely correct itself, was that exclusion of rivals, as such, was of little concern from an antitrust standpoint; there needed to be proof that the market would not correct itself. Today these two conclusions are very much in the mainstream of American antitrust policy and jurisprudence. In fact, they have spawned presumptions that Chicago School adherents contend must be rebutted before antitrust challenges should be allowed to proceed.

More specifically, beginning with the landmark decision in *Sylvania*, the Supreme Court has gradually embraced – with a few exceptions – the Chicago School's perspectives on antitrust.[25] In *Sylvania*, the Court abandoned the *per se* rule against non-price vertical restraints – such as the assignment of exclusive territories and exclusive customers. Drawing on Chicago School scholarship, the Court emphasized the potential efficiencies that could result from such restraints.[26] Thirty years later, the majority in *Leegin* emphasized the same thing in the case of resale price maintenance, at least where the practice is undertaken by a single firm.[27]

Chicago School thought has also greatly influenced the standards applicable to monopolization and attempted monopolization claims brought under Section 2. For example, starting with its decision in *Matsushita*, and later in *Brooke Group*, the Supreme Court embraced a predatory pricing standard under which, consistent with the Chicago School, the exclusion of rivals as such is not significant; a plaintiff is also required to prove both below-cost pricing and

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[25] See, e.g., Aspen Skiing, 472 U.S. 585; Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451 (1992).

[26] Sylvania, 433 U.S. at 54-56.

[27] Leegin, 127 S.Ct. at 2714-16.

recoupment.[28]

The Supreme Court's decision in *Trinko* was concerned with a narrow issue: the obligation that a regulated monopolist has to deal with competitors. However, the opinion described the benefits to society of a dominant firm's refusals to deal with a rival.[29] More particularly, Justice Scalia declared that monopolies and the charging of monopoly prices were "an important element of the free-market system," and the inducement to "attract business acumen in the first place."[30] Beyond that, the Court chose not to endorse the essential facilities doctrine, signaling that the exclusion of rivals in itself should not create concern. This too is consistent with Chicago School thinking.

The addition of two new justices since the issuance of *Trinko*, Chief Justice Roberts and Justice Alito, is unlikely to change the calculus on the Supreme Court when it comes to antitrust enforcement. Indeed, if the last two terms are any indication, the current Court is even more cautious about antitrust enforcement than the *Trinko* court.[31]

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[28] See Brooke Group, 509 U.S. at 226 (echoing the observation in *Matsushita* that "predatory pricing schemes are rarely tried, and even more rarely successful."); Matsushita, 475 U.S. at 589-590 (Matsushita found that "there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful." The Court cited Chicago School scholars Robert Bork, Antitrust Paradox at 149-155; Easterbrook, Predatory Strategies and Counterstrategies, 48 U. Chi. L. Rev. 263, 268 (1981); McGee, Predatory Price Cutting: The Standard Oil (N. J.) Case, 1 J. Law & Econ. 137 (1958); McGee, Predatory Pricing Revisited, 23 J. Law & Econ., at 292-294)

[29] Trinko, 540 U.S. at 407-08.

[30] Id. at 407.

[31] See Leegin, 127 S.Ct. 2705; Twombly, 127 S.Ct. 1955; Credit Suisse Securities LLC v. Billing, 127 S.Ct. 2383 (2007); Weyerhaeuser v. Ross Simmons, 127 S.Ct.1069 (2007); Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc., 546 U.S. 164 (2006); Texaco v. Fouad N. Dagher, 126 S. Ct. 1276 (2006). The Federal Trade Commission has continued enforcement of the antitrust laws by the federal antitrust agencies. More specifically, the Federal Trade Commission pursued 132 antitrust enforcement actions from fiscal year 2003 through the

first half of fiscal year 2007. See Federal Trade Commission, Bureau of Competition, Antitrust Enforcement Activities Fiscal Year 2003 - March 31, 2007, at 1, available at http://www.ftc.gov/reports/aba/abaspring2007.pdf. These actions have included cases involving monopolization and other anticompetitive single firm conduct; the Commission has issued final orders in such cases as Rambus, Unocal, BMS, and Biovail. See In the Matter of Rambus, Inc., Docket No. 9302, available at http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf (Aug. 2, 2006) (opinion finding a violation of section 5 of the FTC Act arising out of deceptive conduct related to standard-setting); In the Matter of Union Oil Company of California, Docket No. 9305, available at http://www.ftc.gov/os/adjpro/d9305/050802do.pdf (Aug. 10, 2005) (decision and order settling monopolization claim through agreement not to enforce patents); In the Matter of Bristol-Myers Squibb Company, Docket No. C-4076, available at http://www.ftc.gov/os/2003/04/bristolmyerssquibbdo.pdf (April 18, 2003) (decision and order barring actions to delay generic entry into pharmaceutical market); In the Matter of Biovail Corporation, File No. 011-0094, available at http://www.ftc.gov/os/2002/04/biovaildecision.htm (April 23, 2002) (agreement containing consent order requiring patent divestiture and barring actions to delay generic entry into pharmaceutical market). The Commission has emphasized enforcement in all sectors of the economy, with a particular emphasis on those areas (such as health care, energy, and pharmaceuticals) that have a major impact on consumers. For a recent summary of Commission antitrust enforcement activity, see An Overview of Federal Trade Commission Antitrust Activities, Prepared Statement of the Federal Trade Commission (presented by Deborah Platt Majoras, Chairman) before the United States Senate, Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy, and Consumer Rights (March 7, 2007), available at http://www.ftc.gov/os/testimony/P072104AntitrustEnforcementActivitiesTestimonySenate03072007.pdf

II. European Antitrust:
A Movement towards Post-Chicago School Economics?

Lars-Hendrick Röller, the former Chief Competition Economist at DG Comp, has mused that by embracing economics, Europe has taken a substantial step toward convergence.[32] Dr. Röller is certainly correct that economic analysis plays a more important role in European Competition law enforcement than it used to play. The European Commission has implemented a number of important reforms intended to bolster its economics capabilities in recent years. For example, the office of the Chief Competition Economist was established in 2003 to give independent advice and support to the Commissioner. Even more significant is DG Comp's effort over the past several years to comprehensively review its enforcement policy – from mergers to unilateral conduct.[33] One goal of that effort is to ensure that policy draws upon "an economically sound framework."[34]

Yet as Dr. Röller acknowledged, although a greater emphasis on economics is a step towards greater convergence, it should not be confused with complete convergence.[35] I suggest

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[32] Lars-Hendrik Röller, Chief Economist DG Comp, European Commission, "Antitrust Economics – Catalyst for Convergence?" (Sept. 20, 2005) available at http://ec.europa.eu/comm/competition/speeches/text/sp2005_017_en.pdf.

[33] See DG Competition, European Commission, *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses* (Dec. 2005), available at http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf; DG Competition, European Commission, DRAFT Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (Feb. 2007) *available at* http://ec.europa.eu/comm/competition/mergers/legislation/draft_nonhorizontal_mergers.pdf

[34] See supra note 4 Kroes, *Tackling Exclusionary Practices*.

[35] See supra note 39, Röller, *Antitrust Economics* at 9 ("final answer by economists in a given case may still be different . . . economists can disagree – both in theory and on empirical analysis & findings").

that one reason why differences remain is that the economics underlying European competition policy and jurisprudence is different from the underlying economics in the United States. Our European counterparts seem to have embraced some of the scholarship that has developed in response to the Chicago School – often referred to as "post-Chicago School" economics.

More specifically, as the Chicago School ascended to dominance (no pun intended) in both American antitrust jurisprudence and policy in the 1980s, economists and lawyers alike began to question some of the fundamental assumptions underpinning the Chicago School's teachings. This came as no surprise. As a friend and former colleague said recently, "nobody ever got tenure for saying that everyone else was right."[36] Scholars such as Michael Whinston, Doug Bernheim, Barry Nalebuff, Steve Salop and others have made efforts to demonstrate that predatory strategies can be profitable under certain circumstances

For example, Professor Whinston's article probed the limitations of the Chicago School's assumption that predatory conduct was rarely profitable and hence generally driven by a quest monopolist but also one with significant anticompetitive effects.[38]

Similarly, raising rivals cost theorists, like Professor Salop, argue that concerted refusals to deal, tying, and exclusive dealing may be more readily explained not as devices for destroying a rival but rather for making their production or distribution more costly, thereby impairing the competitive process and injuring consumers.[39]

Post-Chicago scholars are not urging a return to pre-1970s antitrust law enforcement policies and practices. Rather, they reflect a different approach to the problems posed by dominant firms. Where the Chicago School tends to advocate a hands off approach, based on an over-riding concern about false positives, one could characterize the post-Chicago scholars as counseling a "light touch."

To be sure, post-Chicago School antitrust is not without its critics. A central criticism voiced by some is that post-Chicago theories rely on "possibility theorems" that reveal why

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[38] See e.g., Douglas Bernheim, Remarks at the Bates White Fourth Annual Antitrust Conference:

certain activity could be anticompetitive if a number of conditions are satisfied.[40] According to those critics, those conditions are seldom met in the real world, and they have suggested that post-Chicago School theories lack empirical verification and can lead to false positives.

forecloses competitors from "profitable access to a market."[44] The Discussion Paper's approach, unlike that of the Chicago School, does not assume that the challenged conduct is efficient. The dominant firm can argue that its challenged conduct was efficient – but it bears the burden of proof.[45] Indeed, DG Competition signaled that efficiency, while a defense to a claim of infringement, is not an excuse for infringement – "ultimately the protection of rivalry and the competitive process is given priority over possible pro-competitive efficiency gains."[46] In short, DG Competition is not nearly as cautious about enforcement with respect to single firm conduct as those in the Chicago School. As Commissioner Kroes has stated, "it is sound for our enforcement policy to give priority to so-called exclusionary abuses."[47]

To be sure, the Discussion Paper embraces consumer welfare as the touchstone of Article 82 enforcement.[48] But the term may not mean the same thing as it does to certain Chicago

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[44] Id. at ¶ 58 ("Foreclosure may discourage entry or expansion of rivals or encourage their exit. Foreclosure thus can be found even if the foreclosed rivals are not forced to exit the market: it is sufficient that the rivals are disadvantaged and consequently led to compete less aggressively. Rivals may be disadvantaged where the dominant company is able to directly raise rivals' costs or reduce demand for the rivals' products.").

[45] Id. at § 5.5.3 (discussing the "Efficiency Defense"); see also supra note 8 Lowe, "Remarks on Unilateral Conduct" at p. 6 (Sept. 11, 2006) ("The burden of proving a capability to foreclose and a likely or actual foreclosure effect falls on the authority or plaintiff. However, the burden of proving an objective justification or efficiencies should be on the dominant

School adherents. The Discussion Paper focuses on the effects of the conduct on consumers in the relevant market (i.e., consumer surplus).[49] As Phillip Lowe has emphasized in discussing the Commission's approach to efficiencies in the Article 82 context, "overall, consumers should benefit from the efficiencies, there must be consumer buy-in, and competition shouldn't be eliminated as a result of the practices concerned."[50] In contrast, Chicago School adherents generally think of "consumer welfare" far more broadly, believing the antitrust laws should be applied in a way that maximizes society's wealth as a whole. Put differently, when they use the term "consumer welfare" those scholars refer not just to the welfare of consumers in the output market but to the welfare of all consumers in society.[51]

higher distribution costs and struggled to compete with British Airways in the commercial airfare market. The Court also agreed with the Commission that British Airways's efficiency justifications were unconvincing. The Commission, and the court, did not find that the rebate program was related to cost savings or other efficiency-enhancing measures.[53]

Another example is *France Telecom*. There, the Court of First Instance affirmed the Commission's findings that the dominant provider of broadband services in France engaged in a pricing strategy designed to deter competitive entry and eliminate rivals.[54] France Telecom sought to justify its pricing on the grounds that it was seeking to take advantage of its economies of scale. However, the Commission, and later the court, rejected that justification. The differences with American standards are stark. Evidence of recoupment and competitive effects were nowhere to be found in either the Commission's statement or the court's decision.

One cannot help but be struck by the fact that in the cases alleging predatory conduct by British Airways vis-a-vis Virgin Airlines, the CFI in Europe and the Second Circuit Court of Appeals in the U.S. reached different conclusions (though admittedly, the conduct that was the principal focal point of the analyses differed in the two cases.) One also cannot help but think that if the United States Supreme Court had reviewed the predatory pricing claim in French Telecom it might have reached a different result than that reached by the CFI.

III. Where do we go from here?

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[53] Id. at ¶ ¶ 280-286. I should note, however, that one commentator expressed skepticism about this determination, viewing it as focusing primarily on harm to competitors rather than on harm to consumers. See J. Bruce McDonald, Dep. Asst. Atty. Gen., Antitrust Division, "Cowboys and Gentleman" the College of Europe, Global Competition Law Centre, Second Annual Conference on the Modernisation of Article 82 (June 16-17 2005) available at http://www.usdoj.gov/atr/public/speeches/210873.htm.

[54] France Télécom SA v. Commission of the European Communities, Case T-340/03, 2007 E.C.R. __(CFI 2007).

not all, economists and competition lawyers – even Chicago School adherents – will admit that conduct by dominant firms may sometimes adversely affect competition. Rules of *per se* legality may create the risk that firms will engage in activities that increase the chances that will occur. And that in turn may create a regime of false negatives.

On the other hand, jurisprudence based on post-Chicago School economics is arguably more imprecise and less certain. As previously discussed, some critics contend that post-Chicago School theories may rely on the existence of particular described conditions, which may make for more unpredictably – and error – in the Commission's law enforcement efforts and European judicial decisions. That in turn may make firms more risk-averse. That is not necessarily a good thing either. It may make firms less entrepreneurial, thereby reducing innovation and economic growth.