Comments of James R. Eiszner
Regarding Section 2 Hearings
Project No. P062106

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General Comments

1. I applaud the effort to bring greater definition to the types of conduct that will or will not expose a single firm to liability under Section 2 of the Sherman Act. Without suggesting that efforts to define problematic single-firm conduct are not worthwhile, I fear they will not go far enough to assist the courts, businesses, lawyers, and consumers in identifying conduct that would expose a firm to antitrust liability. Clarity of rules for single-firm conduct is important to single firms who must act appropriately or face liability, but clarity is even more important to consumers. Unclear prohibitions on single-firm conduct will cause many firms to refrain from lawful, competitive conduct that benefits consumers.[1]

While the hearings and resultant report may well reduce the uncertainty concerning conduct that will trigger liability under Section 2 of the Sherman Act for single-firm conduct, two additional topics need to be addressed. First, Section 2 is not the only antitrust statute that governs single-firm conduct. The Commission has long contended that acts that do not violate the letter of the Sherman Act could nevertheless be reachable by Section 5 of the Federal Trade Commission Act if those acts violate the "spirit" of the Sherman Act. At a minimum, the Commission should determine whether it would be likely ever to use Section 5 to challenge single-firm conduct that does not

[1] This is not a fanciful statement. In over 20 years of participating in antitrust compliance programs at numerous companies, I have seen numerous approaches to compliance, yet every program contains the same basic instruction: when in doubt whether the conduct is lawful, refrain from the conduct.

violate Section 2 and, if such a challenge is likely, to articulate the circumstances in which it would be likely to make such a challenge.

Second, even if the enforcement agencies' current efforts are completely successful in defining the single-firm *conduct* that could result in antitrust liability, a great deal of uncertainty would nevertheless remain concerning whether the firm that undertook such conduct was a "monopolist" or was dangerously close to becoming one. Unless the antitrust enforcement agencies provide guidance on when monopoly will be found (or should be found), there remains a significant possibility that firms that are not in fact monopolists (or near monopolists) will refrain from the types of conduct that are problematic for a monopolist (or near monopolist) because of a concern that they could be found to possess (or come dangerously close to possessing) monopoly power. Consumers are harmed by this uncertainty, and the antitrust enforcement agencies should try to prevent that harm. Accordingly, the Commission and the Antitrust Division should define monopoly and monopoly power as part of these hearings.

To be sure, the 1992 Horizontal Merger Guidelines go a long way toward defining relevant markets and help minimize the uncertainty. But they also confuse the issue. For example, under antitrust jurisprudence it should be clear that monopoly power and market power are two separate concepts.[2] But the Guidelines define market power without defining monopoly power (Section 0.1) and, in nearly the same breath, define a "monopolist" as a single seller with market power. (*Id.*) As Alexander Pope has noted, a little knowledge is a dangerous thing; those uninitiated in antitrust matters might take the Merger Guidelines' definitions to mean that a monopolist is defined as the only seller in a relevant market, with the concomitant implication that a monopolist cannot exist in a market that has two sellers. Those who have drunk deeper of matters antitrust know, however, that the Guidelines were only attempting to describe a "monopolist" for

[2] In *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1992), the Court defined market power as "the ability of a single seller to raise price and restrict output." *Id.* at 464 (quoting *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 503 (1969)). But the Court also stated that market power and monopoly power were different: "Monopoly power under § 2 requires, of course, something greater than market power under § 1." *Id.* at 481 (citing *Fortner*, 394 U.S. at 502).

purposes of the hypothetical monopolist test employed by the Guidelines to define a relevant market.[3]

The Guidelines thus do not define monopoly power, but they do provide a useful framework for a definition. The Herfindahl-Hirschman Index ("HHI") is a measure of collective market power (assuming the relevant market has been properly defined). But the HHI can also be a tool to decide the degree of market power attributable to any one firm. One simply calculates a single-firm HHI by squaring the market share of only the firm in question, and the closer that result is to 10,000, the closer the firm is to possessing perfect monopoly power.

Clearly, a single-firm HHI of 10,000 would represent monopoly power. But how far from 10,000 can the single-firm HHI stray before a firm has mere market power and does not have monopoly power? It is important to define the points at which the single-firm HHI creates a presumption of monopoly power. I suggest a conclusive presumption that there is no monopoly power for a single-firm HHI at 1600 and below (in other words, a 40% market share or less) and a rebuttable presumption between 1600 and 4900 (above 40% and at or below 70%). Anything above 4900 would create a presumption of monopoly power, with the strength of the presumption increasing as the single-firm HHI approaches 10,000. Of course, if this approach were used, it would still be important to consider factors beyond the HHI which would inform the monopoly power determination (ease of entry/expansion, for example). Moreover, if this approach were used, an important caveat would be that the single-firm HHI is not relevant to an attempt to monopolize claim except to evaluate whether the firm would have monopoly power *after* (and assuming) the success of the relevant exclusionary conduct.[4]

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3 One hopes that future revisions of the Guidelines will state this more explicitly.

4 The single-firm HHI concept can also be used to articulate when a firm is likely to have market power, and I would encourage the antitrust enforcement agencies to articulate the single-firm HHI ranges at which market power would be presumed not to exist (perhaps below 900 and certainly below 400); at which market power, but not monopoly power, would be presumed to exist (400, or 900, at the low end of the range, but at or below 1600 at the top); and at which market power would be presumed but monopoly power could be shown (1601 to 4900).

One more suggestion must be made if a single-firm HHI is to have any relevance to determining whether a monopoly exists. There is a circularity in the Guidelines where monopoly is potentially involved. Under the Guidelines framework, a monopolist is unconstrained in its pricing by competitors in the relevant market, while firms with some or no market power are constrained in their pricing by competitors in the market. Yet the Cellophane Fallacy applies to monopoly: a rational monopolist will raise the prices of its products until losses of sales to products *outside* the relevant market make further increases unprofitable. There is thus a substantial risk that the small but significant price test for market determination could identify (incorrectly) a market based on pricing constraints from firms who are outside the market. The Guidelines attempt to break this circularity by considering the profitability of prices in the existing market and by postulating lower prices if there is evidence that current prices are inflated by "coordinated interaction." (Section 1.1.) While coordinated interaction can certainly raise price above a competitive level, it is equally true that the operation of the Cellophane Fallacy may also do this. Any approach that uses the Guidelines to identify monopoly must make this clear and should explain how the enforcement agencies identify when prices are not competitive for purposes of applying the Guidelines market test.[5]

Even if this precise approach is not followed, the enforcement agencies should use the present hearings as an opportunity to define and explain how they would test for monopoly power. Courts have struggled with the concept of defining the terms "monopolist" and "monopoly power."[6] None of the definitions proposed in these

5 Unfortunately, the recent FTC/DOJ Commentary on the 1992 Horizontal Merger Guidelines did not provide significant illumination as to how the agencies resolve the issue of non-competitive prices when applying the hypothetical monopolist test.

6 Some courts imply monopoly power is a significant amount of market power, without proffering a standard for significance. *See Kodak, supra,* 505 U.S. at 481. Others define market power as the power to raise price or exclude competition but define monopoly power as the power to do both. *See Borough of Lansdale v. Phila. Elec. Co.*, 692 F.2d 307, 311 (3d Cir. 1982); *Richter Concrete v. Hilltop Concrete Corp.*, 691 F.2d 818, 826 (6th Cir. 1982); *Nat'l Reporting Co. v. Alderson Reporting Co.*, 763 F.2d 1020, 1024 (8th Cir. 1985); *Tarabishi v. McAlester Regional Hosp.*, 951 F.2d 1558, 1567 (10th Cir. 1991); *Neumann v. Reinforced Earth Co.*, 786 F.2d 424, 430 (D.C. Cir.), *cert. denied,* 479 U.S. 851 (1986). Still others draw no distinction between market power and monopoly power. *See, e.g., Int'l Distrib. Ctrs., Inc. v. Walsh Trucking Co., Inc.*, 812 F.2d 786, 791 n. 3 (2d Cir. 1987) ("'Market power' is a synonym for 'monopoly power.' We have previously defined 'monopoly power' as 'the power to control prices or exclude competition . . . in the

decisions provide any meaningful guidance to future judges or juries on the conditions necessary for monopoly power.[7] If the Antitrust Division and the Commission feel that hearings are necessary on these definitional issues, I would recommend that it schedule hearings on these issues, either in connection with their current hearings or in a future effort.

2. The hearings will presumably result in some conclusions being reached on the legality of single-firm conduct. In expressing these conclusions, it would be helpful if the conclusions were set forth in the context of what acts a monopolist (or near monopolist) could not undertake that other firms in the market could undertake and if an explanation were provided as to why a monopolist or near monopolist could not undertake those actions when a competitor could. As Judge Easterbrook has noted, competitive conduct by a monopolist is as beneficial to consumers as is competitive conduct by non-monopolists, and by its very nature it excludes competitors.[8] Clients who are advised that their unilateral conduct may run afoul of the antitrust laws often ask why they cannot undertake conduct that their competitors could. By expressing the conclusions of these hearings within the framework I propose, the antitrust enforcement agencies will give antitrust practitioners a basis to respond to this question. Moreover, adopting this framework will help insure that the conclusions reached are true to the purpose of consumer welfare enhancement.

It would also assist the business community and consumers if the Antitrust Division and the Commission considered whether there are "safe harbors" that can be

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relevant market.'"); *Tops Markets, Inc. v. Quality Markets, Inc.*, 142 F.3d 90, 97-98 (2d Cir. 1998); *Cost Mgmt. Servs. v. Wash. Natural Gas Co.*, 99 F.3d 937, 950 & n.15 (9th Cir. 1996) (same).

7 Perhaps the most bizarre example of a case that provides no guidance is *Re/Max International v. Realty One, Inc.*, 173 F.3d 995 (6th Cir. 1999), in which the court held that monopoly power could be shown by direct evidence that the defendant could raise price and exclude competition. Under this approach to identifying monopoly power, the owner of a patent would almost always be a monopolist: its patent carries the power to exclude competition, and patents very often give their owner some ability to raise price. Yet, as the Supreme Court recently held, most patents do not confer monopoly power on their owners, and the ability to raise prices somewhat above a competitive level is not evidence of a non-competitive market. *Illinois Tool Works, Inc. v. Indep. Ink, Inc.*, 547 U.S. ___, 126 S. Ct. 1281, 1292-93 (2006). It is vitally important that the direct evidence test not be imported into the jurisprudence concerning monopoly power.

8 Frank H. Easterbrook, *On Identifying Exclusionary Conduct*, 61 Notre Dame L. Rev. 972, 972-73 (1986).

articulated for single-firm conduct that would not run afoul of the antitrust laws. While some firms with significant market positions might desire to come as close as possible to the line between legality and illegality, it is far more typical that a company in such a position will want to conduct its affairs to stay far enough from the line that its actions cannot even be challenged as unlawful. Providing safe harbors will prevent a situation where such a company pulls its competitive punches more than is required to stay safely within the bounds of the law, and in so doing will prevent harm to consumer welfare.

3. Antitrust must evolve with American industry, and that industry is changing rapidly. In traditional manufacturing industries, development of a market came slowly. When traditional manufacturing prevailed in the American economy, it was almost a truism that a firm that was a distant number two in size in a relevant market could not attempt to monopolize that market. The idea that a second firm could overtake a much larger firm and dangerously threaten to monopolize the market was fanciful in a traditional manufacturing business. That notion was rejected in *United States v. Microsoft Corp.,* 253 F.3d 34 (D.C. Cir. 2001) (finding no Section 2 violation in the browser market where Microsoft was a distant second in share, but not because there was no likelihood that Microsoft would overtake its larger rival), where high technology products were involved. In light of the fact that the typical American business is now more high tech and fast-paced than ever, the antitrust enforcement agencies should consider and provide answers with respect to an important question: can a firm attempt to monopolize, or monopolize, a market that does not yet exist?

There is authority for the proposition that a firm cannot monopolize a market that does not yet exist by acquiring a patent, even if it is foreseeable that the patent will give the acquirer a monopoly position in the market. *SCM Corp. v. Xerox Corp.,* 645 F.2d 1145 (2d Cir. 1981). In principle, the result in this case is correct – the owner of the patent was going to possess a monopoly, and consumers should be indifferent as to who owned the patent and inherited the monopoly – but it might not be correct in other contexts. For example, a regulatory barrier to creation of a new market may be coming down in the foreseeable future: would a company be able to take advantage of the *SCM* decision if it took actions to lock up all the prospective consumers in the new market with long-term contracts?

The agencies need to address this issue. In my view, it would be appropriate to limit *SCM* to the patent acquisition context and to focus on the issue of intent. If the exclusionary actions taken today with respect to a future market would foreseeably result in a monopoly of the future relevant market (and that monopoly does not flow from a patent grant), the party taking those actions could have the specific intent necessary to monopolize a market and could be held liable. Since specific intent is required for attempted monopolization but not for the monopolization offense, *compare Spectrum Sports Inc. v. McQuillan,* 506 U.S. 447 (1993), *with Swift & Co. v. United States*, 196 U.S. 375 (1908), it may be necessary to limit the holding that only general intent is required for a monopolization offense to instances where the market being monopolized already exists at the time of the exclusionary acts.

4. Of the specific categories of single-firm conduct set forth in the notice of the hearings, several (tying, exclusive dealing, and discounts) are not issues unique to single-firm conduct. These categories involve joint action, are reachable under Section 1 of the Sherman Act and have traditionally been analyzed under Section 1. To be sure, when a monopolist engages in a Section 1 violation in the monopoly market, it will also violate Section 2. But the Section 2 claim is superfluous. The analysis of these categories of conduct depends on degrees of foreclosure, which in turn depend on market share. Except for *per se* tying, the Rule of Reason is employed and takes account of the competitive implications of the practice. Section 1 violations can be proven without the need to show monopoly or monopoly power, but tying and Rule of Reason analysis do take into account whether the party imposing the restraint has market power and the degree of that market power. The hearings may actually confound or unduly complicate the antitrust analysis by looking at these categories of conduct in the context of single-firm conduct. Before the antitrust enforcement agencies articulate standards for evaluating these categories in the context of single-firm conduct, the agencies should consider whether it is necessary to provide special standards for individual firms

engaging in such conduct, and if so, whether articulating those standards is possible without impacting the analysis traditionally applied to evaluate such conduct under Section 1.

5. My last general comment pertains to the issues of burden of proof and burden of persuasion in antitrust analysis. The antitrust enforcement agencies have been reticent to address these topics in other guidance. The 1992 Horizontal Merger Guidelines, for example, contain a disclaimer that they do not articulate burdens of proof or persuasion. (Section 0.1.) It would severely undercut the utility of the results of the current hearings if the antitrust enforcement agencies were to take the same position with respect to single-firm conduct.

An example makes the point. Suppose that the results of the hearings are that a particular category has the potential for both positive and negative effects on consumer welfare and will be condemned only if, on balance, there is a net negative effect on consumer welfare. Balancing of consumer welfare effects is an extremely difficult task. Putting the burden on the party engaging in the conduct will likely deter anticompetitive conduct by responsible firms but will also deter some competitive conduct: a responsible firm will only engage in the practice when it can clearly show that consumer welfare is better off and will avoid conduct where it is probable (though not certain) that consumers are better off. Putting the burden on the party challenging the conduct, however, will not improve the deterrence of anticompetitive conduct (responsible firms will still want to avoid close cases because they clearly cannot know exactly how the balance will be struck) but will deter procompetitive conduct to a lesser degree.[9] If the results of the hearings do not clearly articulate who bears the burdens of proof and persuasion, the result will be to deter conduct that probably, but not certainly, makes consumers better off. If the results of the hearings do not include a full discussion of burdens of proof and persuasion, the hearings will do little or nothing to add certainty

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9 I do not discuss irresponsible firms because they are unlikely to care about agency guidance at all. They will engage in conduct without regard to assignment of burdens of proof and persuasion.

to the law of single-firm conduct and may create additional uncertainties that discourage conduct that benefits consumers.

Specific Comments

I do not intend to comment on every category of single-firm conduct that is proposed for coverage in these hearings. There are, however, several topics on which I have specific comments:

Loyalty Discounts and Market Share Discounts

The major error in most of the prevailing discussions of discount and rebate programs is that they fail to look at the issue of causation properly. Their focus is exclusively on the intent of the firm offering the discount. Clearly, a firm that offers a program that provides for a discount or rebate if the customer meets an objective intends for the customer to meet that objective. If the customer subsequently satisfies the criteria for the discount or rebate, the temptation is to assume that the rebate program has caused the customer to meet those criteria. Indeed, one also is tempted to assume that the customer, even if it does not satisfy the condition for the discount, has tried to meet that condition with some foreclosure effects.

These assumptions are erroneous, however, because they fail to look at the discount or rebate program from the customer's perspective. Customers – and especially large, sophisticated ones – will *always* accept a rebate or discount program, but they will not necessarily try to meet the conditions for the rebate or discount. It is costless to accept a rebate or discount program. The customer is no worse off for agreeing to one. A skeptic might ask why a customer would agree to a program if it was not going to try to qualify for the discount or rebate. The answer is simple: the customer intends to do, and in fact does, whatever it was going to do absent the program, and should the customer happen to qualify for the rebate or discount, it has received a windfall. The situation is analogous to an offer of a free lottery ticket: game theory teaches that this offer should always be accepted since there is no cost to the ticket and there is a potential benefit.

This conclusion – that customers will often accept discount or rebate programs even though they have no intent to change their conduct to qualify for program benefits – is supported by more than just game theory. In my practical experience, I have encountered several situations where the customer has told me that it signed onto a rebate or discount program, even though it had no intention to modify its conduct in order to qualify, precisely because it was costless to sign onto the program and it might receive a windfall. Indeed, in one case, the customer informed me that it recognized the program could have exclusionary consequences for the competitors of the program's offeror and that it intended to conduct its purchasing program so as to sustain the viability of these competitors, but that it nevertheless signed onto the program because it might be able to support the viability of the competing suppliers and still qualify for the program benefits.

The exclusionary effects of rebate and discount programs should not be judged solely on the basis of the intent of the party offering the program, and no inference whatsoever should be drawn from the fact that some or all customers have accepted that program or received program benefits. A discount or rebate program must be shown to be exclusionary on the basis of evidence that customers actually altered their purchase decisions in order to meet the criteria for the discount/rebate. Moreover, a rebate or discount program has the potential to be exclusionary only to the extent that customers do actually modify their purchase behavior because of the program.

An additional causation issue exists with respect to market share programs, especially those where the program benefit (price reduction, rebate, or other) is contingent on the customer allocating a specific percentage of its promotion or advertising to the program sponsor. In my experience, many customers will dictate to their suppliers that they intend to allocate a specific share of product category advertising or promotion to the supplier's products and ask what discount would be available at that level. The supplier responds, often by tendering a market share discount that is tailored to the level of advertising or promotion that the customer has dictated to the supplier. In many cases, the share percentage used in the program is higher than the market share of the supplier, either with that customer or in the market in general (especially in retailing, where retailers do not like to advertise or promote smaller brands). It is incorrect to consider such a program to be exclusionary in this situation: the customer, not the supplier, has taken the exclusionary act, and the discount program merely reflects the customer's decision.[10]

Bundled Discounts

My comments with respect to causation for loyalty and market share discounts also apply to bundled discounts, albeit with somewhat less force. It simply does not follow that, but for the bundled discount, a customer would have purchased one of the items in the bundle from another supplier. This is true regardless of past practice. Customers, and especially those who have purchasing departments, have no interest in furthering a scheme that would reduce competition in a supply market. With respect to especially sophisticated customers, acceptance of the bundled arrangements *may* actually be evidence that the tying arrangement will *not* foreclose competitors – either the customer does not feel competitors of the tied (bundled) good will be affected or, if they will, the affected competitors were not ones from whom the customer was going to purchase anyway.[11] In that event, it would be improper to assume causation/forcing.

Another aspect of causation deserves attention when bundling is being considered. Most of the cases to date appear to have assumed that a firm that does not have a corresponding set of products to match that of the firm offering the bundled rebate is defenseless. But a firm in danger of being excluded from a market because of a bundled rebate should be able and highly motivated to work with other firms to develop a competing multi-firm bundled rebate program. Absent some proof that competitors actually attempted – but failed – to create a multi-firm bundled rebate program, courts

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10 If, however, the customer asks the supplier to provide discounts for various levels, the situation is vastly different. By definition, such a customer has not decided what level of advertising or promotion it will allocate to the supplier, and the program then has the potential to cause exclusion of rivals.

11 Of course, it may be true that there is a tying good in the bundle which the customer must buy so that it is truly coerced into buying the bundle without regard to the impact of competition on the tied goods in the bundle. It may also be true that a purchasing agent is short-sighted and therefore ignores the fact that the long-term harm to competition in one of the bundled products may exceed the short-term gains from the bundled discount. But these things should be proven if causation/forcing is to be established.

should not permit any firm to maintain a claim for exclusion based on a bundled rebate.[12] If, however, a bundle is predatory (because the price for the bundle is below the appropriate measure of cost for the bundle), it makes no sense to require a firm to incur the costs of assembling a competing bundle because those costs would only increase the firm's damages.

The law as it relates to bundled discounts is in a state of confusion. In my view, this confusion largely stems from misplaced expectations by lawyers and/or courts that there is or should be a single theory of antitrust law that determines whether bundled discounts are legal or illegal. If, however, one realizes that bundled discounts are a category of conduct to which several antitrust theories of liability may apply, much of the confusion disappears. There are three theories under which bundled discounts may potentially result in liability under the Sherman Act: predatory pricing; monopoly leveraging; and tying. Each of these theories has some limitations: under predatory pricing, the bundle must be below an appropriate measure of cost; under monopoly leveraging, the bundle must threaten to achieve a monopoly or maintain one; and under tying, a plaintiff must show economic coercion. If analysis of bundled rebates is considered in light of these traditional antitrust theories, the treatment of bundled rebates is less uncertain.

To be sure, antitrust law must evolve, and the agencies should not blindly adhere to theories because they are traditional or because they reduce uncertainty. If there are new theories which better protect consumer welfare and are more administrable, they should be adopted. Some have advocated use of a profit-sacrifice test with regard to bundled rebates. Adoption of such a test will harm consumer welfare. It will force legal advisors of any company that could plausibly be argued to possess or be near a monopoly to provide a rule of thumb to their clients that price cuts (whether or not in the form of a

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12 In this context, some consideration should be given to whether a competitor faced with possible exclusion due to a bundled rebate has a duty to mitigate its damages and whether a competitor should be able to include in its damages the cost of any unsuccessful mitigation. It is not costless to assemble a competing bundle, especially when multiple firms are involved. It is also inherently uncertain whether those costs will be recovered or that the competing bundle will succeed. Sound policy requires that firms take affirmative efforts to mitigate their exclusion from a market and that firms that are not successful in this mitigation effort are entitled to include the cost of unsuccessful mitigation in their damages recovery.

bundled rebate) are permissible only if they are above cost and defensive. This is so because the profit-sacrifice test permits *ex ante* evaluation of the bundled rebate. A firm that misjudges the demand curve of one or more of the bundled products (or of the bundle as a whole) may find that its profits from a bundled rebate did not increase and could be found liable under a profit-sacrifice test. The same result may obtain if the company thinks that a competitor will reduce prices on a product and institutes a bundled rebate program in anticipation of that price reduction but the price reduction never materializes and was never planned. Moreover, if the profit-sacrifice test applies to bundled rebates, there is nothing to cabin that rule from applying to other types of price reductions. The predatory pricing rules apply equally to bundled rebates and price cuts, so it is likely that if the profit-sacrifice test applies to bundled rebates, it would apply to pure price reductions as well.[13] It is not in consumers' interests to establish a rule that forces firms that could be argued to be a monopolist (a group which includes monopolists and non-monopolists) to lower prices only in response to price cuts from competitors. The antitrust enforcement agencies should not advocate application of a profit-sacrifice test to bundled rebates.[14]

Predatory Pricing

I anticipate most of the comments on this topic will address the appropriate cost standard for predatory pricing, and I will not add to that discussion. Instead, there are several additional issues related to predatory conduct that I will address. It will do little to clarify the law of predatory pricing if these additional topics are not considered and addressed by the antitrust enforcement agencies.

First, standards are needed for determining the products for which costs should be measured to determine predatory pricing. There are few one-product firms capable of predation, and where a firm has several products, economies of scale and

[13] The problem is somewhat less severe in the case of pure price cuts. Bundled rebate programs tend to be annual or quarterly and cannot easily be retracted if they prove to be unprofitable. In contrast, a company that simply reduces its prices can quickly raise them again if the price cut was not as successful as the company anticipated when it implemented the price cut.

[14] For the same reason, a "no economic sense" test for bundled rebates harms consumers. Responsible companies have no way to steer clear of second-guessing of their pricing decisions unless a bundled rebate is defensive – a reaction to announced moves by competitors – and above cost.

scope often dictate that the different products share ingredients, components and/or production facilities. Food and beverage products often share a substantial number of ingredients, components, or production facilities (small package of beans vs. large package of beans; 2-liter soft drinks *vs.* 1-liter soft drinks of the same brand, etc.). Even different car models that come from different assembly lines may share enormous numbers of parts. Because of the inherent uncertainty of allocating costs, it is preferable to lump products sharing significant components/ingredients/production facilities together and to determine predation by examining whether the net aggregate revenue from the products exceeds the aggregate appropriate costs. But under what circumstances would this be inappropriate?

Clearly, all of the products in the relevant market that is the subject of predation ought to be included in determining whether the price is predatory. If bulk green beans compete with frozen green beans, the producer that sells bulk green beans at a profit and frozen green beans at a loss cannot be predating in a relevant market unless his aggregate revenues for both exceed some measure of the aggregate appropriate cost for both.[15] If it were otherwise, the predation would fail to drive competing green beans from the market, and monopoly likely would not be achieved. (If, however, the predating party already faces no competition in bulk green beans, it may be appropriate to look only at the price of frozen green beans pursuant to the concepts articulated below.)

A harder question arises where the products are in different markets. In such a situation, the issue ought to be dependent on minimizing the risk of error introduced by allocating costs between products. If the products in question share ingredients/components/costs that account for at least 50% of the cost of the product claimed to be the subject of predation, the products should be lumped together and

[15] One might argue that this conclusion conflates the concepts of recoupment and below-cost pricing. While that may be true, the law does not outlaw below-cost pricing *per se,* and it makes no sense to worry about below-cost pricing within the context of monopolization unless the below-cost pricing dangerously threatens the exercise of monopoly power. While there may be situations where a market could be monopolized by only predating against some of the products in the market, those situations are rare. The benefits of developing a rule that would capture those situations do not come near to offsetting the costs of that rule: the very complexity of the rule would chill aggressive price cutting that benefits consumers.

predation determined on an aggregate basis; otherwise, the costs should be allocated as best as possible to each product and predation determined separately.

The time period for which costs are measured is also important. A firm should not be at risk of being found liable for predation because it is at capacity and needs to build more capacity such that the next unit of production has a marginal cost in excess of the sales price for that unit. To some degree, this can be alleviated by the adoption of a long-term measure of cost as the appropriate measure for determining below-cost pricing. But that will not entirely resolve the problem: consider the possibility of an enormously expensive automobile assembly plant with an anticipated life of 50 years being measured against a long-term cost standard of 5 years. Plant costs ought to be allocated based on the anticipated sales of the plant during its expected useful life. In many cases, this can be determined from documents generated during the capital requisition and planning process for the plant, although in some cases those documents could be disregarded if there is evidence that they were written with the intent to manipulate the cost standard for predation.

Second, the Commission and Antitrust Division should address the relationship between the profit-sacrifice test and the predatory pricing test. I share many of Professor Elhauge's criticisms of the profit-sacrifice test, *see* Einer Elhauge, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. 253 (2003), and hope that the standard is rejected generally. But if the antitrust enforcement agencies adopt it, they must explain how it relates to predatory pricing. For example, a price cut may be non-predatory because it is above the appropriate measure of cost, but it still may fail some iteration of the profit-sacrifice test: is the price cut exclusionary and illegal because it failed the profit-sacrifice test, or is it lawful because it is not predatory? In my view, the latter answer is preferable because public policy ought to encourage non-predatory price cutting.

Third, the antitrust enforcement agencies should create a safe harbor for pricing that falls below the appropriate measure of cost. I will leave it to others to discuss what the appropriate measure might be but would encourage the Antitrust Division and Commission to articulate safe harbors, even if there is no agreement reached on the precise standard. Moreover, safe harbors should be articulated that address pricing duration. Short-term promotions, including product give-aways or deep price cutting, will not threaten to create a monopoly in any but the rarest of instances.[16] In my experience, companies frequently refrain from short-term price promotions that are below full cost for fear of an accusation of predation by their competitors. Because short-term price cuts improve consumer welfare in both the short and long term, the Commission and the Antitrust Division ought to announce a safe harbor that any price cut (or product give-away) that is less than four months in duration ought to be presumptively non-predatory.

Lastly, I would invite the antitrust enforcement agencies to consider the role of intent in predation cases. There is a debate whether predation plays a role only in the jurisprudence of attempted monopolization or is a possible monopolizing offense as well. I tend to side with those who contend that it only plays a role in attempt violations, largely because of a plausibility issue associated with predation by a monopolist (arguably, a monopolist can charge monopoly prices in the present and has no need to incur predatory losses). A showing of specific intent is required as an element of the attempted monopolization violation. While intent evidence is often ambiguous, specific intent (and hence predatory pricing) would not exist where a dominant firm merely matches the price of a competitor for the duration that the competitive price is offered (as where a new entrant offers a below-cost price to seat itself in the market and the dominant firm matches it). A safe harbor should be established for below-cost price cuts that are in response to a competitor's price in the market and that are no lower than the amount of, and no longer than the duration of, the competitor's price.

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16 Even in the rare instance where short-term price cuts do push competitors out of a market, the likelihood is substantial that the exiting competitors would have exited from the market in any event, even if there had been no short-term price cut.

Monopsony Conduct

Although it is not listed as a particular type of conduct on which the hearings are expected to focus, monopsony conduct is deserving of attention. There is a dearth of learning about monopsony,[17] and it is impossible to counsel clients on the subject. The inability of private practitioners to provide clients with meaningful guidance as to the circumstances under which the enforcement agencies (and courts) would find monopsonistic behavior to be illegal causes many clients to be significantly less aggressive in taking steps to drive costs out of their supply chains to the detriment of consumer welfare. The Antitrust Division and the Commission should develop and articulate guidance concerning the circumstances which would likely cause them to pursue single-firm purchasing conduct as illegal monopsonistic behavior. I would also encourage the agencies to reject the notion that monopsony and market power are similar concepts. While it is convenient to think of one as seller power and the other as buyer power, treating the concepts as mirror images obscures the very important fact that the two concepts have quite different effects on consumer welfare.

In my view, monopsony is to a large degree a theory in search of a practical problem. In many cases, the consumer welfare effects of monopsony are ambiguous, such that antitrust law should not intervene. In most other cases, the monopsony problem is part of a larger problem that can be reached by the antitrust laws in other ways.

Monopsony – the use of purchasing power to drive the price of a purchased good (or service) below a competitive level – will always cause society harm by misallocating resources. But in most cases, the alleged monopsonist faces a competitive output market for the product it purchases (in which market the monopsonist either re-sells the good or sells another good in which the monopsonized good is an ingredient or component). In such a case, competition in the output market forces the monopsonist to pass on most or all of the sub-normal purchase price paid in the

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[17] Most of the key academic discussion is contained in two articles, Jonathan M. Jacobson & Gary J. Dorman, *Joint Purchasing, Monopsony and Antitrust*, 31 Antitrust Bull. 1 (1991), and Roger D. Blair & Jeffrey L. Harrison, *Antitrust Policy and Monopsony*, 76 Cornell L. Rev. 297 (1991).

monopsony input market.[18] In such a case, monopsony *benefits* consumers, but harms suppliers of the monopsony good in the input market, and misallocates society's resources. This ambiguous welfare effect is much like the welfare effect of above-cost predatory pricing, and the same sound policy considerations which counsel against prosecution of above-cost predation apply. If a company facing competitive output markets tried to monopsonize an input market, antitrust enforcement would actually make consumers worse off.

Of course, in such a scenario, a company facing competitive output markets would not benefit from monopsony conduct and has no motive to undertake it. But even in situations where a company has some market power in the output markets, consumers likely will be better off if there is no enforcement action unless the supposed monopsonist is able to retain *all* of the benefit of the sub-normal monopsony price or if the monopsonist is able to use the monopsony benefit to predate in the output markets, allowing it to claw back the monopsony benefits it has passed onto consumers by later raising prices when all of its output competitors are driven from the output markets.

A monopsonist facing non-competitive output markets has a problem with exploiting its monopsony power without predation. The exercise of monopsony power requires it to pay too little for the monopsony good and causes the monopsonist to buy *too much* of that good (thereby producing the misallocation of resources). But a monopsonist that faces a non-competitive output market has a conflicting problem: to exercise market power in the output market, it must supply *too little* of the output good. If the monopsonist attempts to constrict the supply of the output good, it will have a stockpile of the monopsonized input. Stockpiled inputs are costly: indeed, cost management is often measured by inventory turnover, which measures a company's ability to avoid costly stockpiles. These stockpiling costs may offset or eliminate the monopsony profits (although not necessarily the profits from the market power in the

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18 Systems competition involving equipment and aftermarket parts/service is similar but not identical. A monopsonist facing competitive output must pass on the sub-normal pricing to consumers who benefit from that lower price, whereas in systems competition, consumers pay normal prices in the aftermarket because they have been protected from exploitation in the aftermarket by foremarket competition.

output market). While monopsony exploitation in this fashion is possible, it is only possible by expensive stockpiling.

The monopsonist may have another, less problematic alternative. It might attempt to use its monopsony profits to subsidize predation in the output market by pricing below its competitors' costs. By lowering its output prices, the monopsonist is not faced with a stockpiling problem – both input and output markets are expanding. But such conduct does not harm consumer welfare unless the monopsonist can later recoup the sub-normal input prices by raising output prices later. Antitrust already has a means to challenge predation in the output markets, and predation through monopsonization could be attacked under the existing predation standards.[19]

Lastly, the Robinson-Patman Act, whether or not it is ultimately repealed, may serve a useful purpose when it comes to identifying a monopsony price. In my experience, purchasing managers understand the concept of the cost-justification defense to the Robinson-Patman Act. Since cost-justified price discounts reflect the purchasing efficiency of the buyer, it would never be appropriate to condemn as a monopsony price any discount that reflects the lower costs of dealing with the buyer from a supplier list price that is profitable to the supplier. Any other approach would discourage efforts to drive costs out of the purchasing system.

Based on the foregoing, it is possible for the agencies to provide some safe harbors for monopsony behavior, even if they cannot provide precise criteria for when monopsony behavior will be illegal. First, monopsonist conduct will not be challenged where output markets for the monopsonized good are competitive. Second, if the monopsonist in a non-competitive output market prices the output below some appropriate measure of cost, the antitrust enforcement agencies can condemn the predatory pricing in the output market but will not condemn the monopsony conduct

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19 Provided that agencies and courts adhere to the strict showing of recoupment, one alteration might make sense in the monopsony predation context: because monopsony may have reduced the predator's costs below a competitive level, it might be acceptable to find a price to be predatory if it is below the appropriate measure of cost using the cost for the input that would have prevailed but for the monopsony. The burden of proof on the but-for price should rest on the party asserting monopsonization.

standing alone. Third, where the output markets are not competitive and there is no predation in those markets, the agencies will not proceed with a monopsony claim absent some proof that the alleged monopsonist is stockpiling the monopsonized product by buying significantly more than it needs for the reasonably foreseeable future (and/or seeking purchase commitments that significantly exceed its future needs as reasonably foreseen at the time the commitment was made). Finally, a safe harbor for determining a monopsony price should be articulated: no price will be deemed monopsonistic if the list price is profitable and the discounted price to the alleged monopsonist reflects only the lower costs of dealing with it as a customer.

The antitrust enforcement agencies may also wish to consider making a statement that it is rarely necessary to challenge monopsonistic behavior because it can be reached under other, more clearly understood theories (the predatory pricing scenario outlined above) and because of plausibility problems (the inconsistency between monopsony expansion of input and monopoly restriction of output, and the problem that true monopsony often threatens the viability of the suppliers to the monopsonist, thereby threatening the monopsonist's viability). While it is probably an overstatement that monopsony theories never have viability, in my experience monopsony is a rare problem. Yet law-abiding business people tend to pull their competitive punches because of concerns about monopsony issues – and they do so far more than would be justified by economic theory. Because pulling those competitive punches hurts consumers, it would be in the public interest if the enforcement agencies made a statement that single-firm monopsony claims (as opposed to cartels that seek to exercise monopsony power) are rarely of antitrust concern.

Conclusion

Uncertainty in the law respecting single-firm conduct undoubtedly hurts consumer welfare. Uncertainty creates situations where strong competitive firms may refrain from procompetitive activity for fear that their actions could later be challenged as monopolization. Uncertainty may also cause truly dominant firms to engage in anticompetitive conduct because they sense the antitrust enforcement agencies have no clear enforcement intentions. The instant efforts of the Antitrust Division and the Federal Trade Commission will therefore improve consumer welfare if those efforts lead to greater clarity in the law. I am appreciative that the antitrust enforcement agencies have enlisted the public in this endeavor and hope that my comments will help focus these efforts. If the agencies desire further elaboration on any points contained in this comment, I would be pleased to provide it.

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