MEMORANDUM

From: Single-Firm Conduct Working Group

To: All Commissioners

cc: Andrew J. Heimert and Commission Staff

Date: December 21, 2004

Re: Single-Firm Conduct Issues Recommended for Commission Study

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The Antitrust Modernization Commission assigned to the Single-Firm Conduct Working Group the responsibility to analyze issues relating to single-firm conduct, and, based on that analysis, to make recommendations to the Commission as to the issues within that category that warrant substantive review. This memorandum outlines those recommendations. The memorandum addresses first the issues the Working Group recommends for substantive consideration and then addresses those issues not recommended for further study at this time. In each instance, comments are provided to allow insight into the Working Group's analysis. The issues are listed in approximate order of priority that the Working Group believes each issue should have for Commission study.

This memorandum reflects the consensus of a majority of the Working Group members. Some members of the Working Group may disagree with a recommendation and/or with aspects of the discussion and comments associated with a recommendation. In addition, a recommendation that the Commission should not study a particular issue at this time does not constitute a recommendation on the merits of the issue, nor does it preclude the possibility that the Commission report ultimately will endorse any particular recommendation.

SUMMARY OF RECOMMENDATIONS

Issues recommended for study. The Working Group recommends that the Commission study the following issues:

1. **Are there features of the modern (or "new") economy that warrant different treatment — whether harsher or more lenient — of single-firm or vertical conduct in "new economy" industries?**
2. **Should the Robinson-Patman Act be repealed in whole or in part, or otherwise be modified?**
3. **Should the substantive standards for determining whether conduct is exclusionary or anticompetitive under either Section 1 or Section 2 of the Sherman Act be revisited?**
4. **Should there be a new statute that would prohibit covert unilateral solicitations of competitors to fix prices, rig bids, divide territories, or allocate customers?**
5. **Should the antitrust laws be clarified so that they reach, or reach more effectively, exercises of buyer power?**

Issues not recommended for study. The Working Group recommends that the Commission not study the following issues:

6. **What are appropriate standards for defining markets in merger cases, rule of reason cases, and monopolization cases? Should market definition continue to an essential element of the proof in cases where significant market power can be demonstrated through more direct methods? If not, should Clayton Act Section 7 and Sherman Act Section 2 be amended accordingly?**
7. **Should the primary-line aspects of Section 2(a) of the Robinson-Patman Act and the provisions of Section 3 of the Clayton Act be repealed as duplicative?**
8. **Should Section 8 of the Clayton Act (interlocking directorates) be repealed or modified?**
9. **Should resale price maintenance be defined legislatively as a Rule of Reason offense?**

<u>DISCUSSION OF RECOMMENDATIONS</u>

<u>Issues recommended for study</u>

The Working Group recommends that the Commission study the following issues:

1. **Are there features of the modern (or "new") economy that warrant different treatment — whether harsher or more lenient — of single-firm or vertical conduct in "new economy" industries?**

Are different standards of market definition needed or appropriate for "new economy" industries? Should entry barriers in these industries be viewed differently? More particularly, in industries where technological change is key, do existing antitrust doctrines (mainly derived from static economic theory) need to be altered? For example, should short-run effects be ignored when innovation replaces products every few years? Should market power be based on a time horizon for entry that is longer than the two years provided for in the *Horizontal Merger Guidelines*? *See* U.S. Department of Justice & Federal Trade Commission, *Horizontal Merger Guidelines* § 3.2 (Apr. 1997), *available at* http://www.usdoj.gov/atr/public/guidelines/hmg.htm. Conversely, given the existence of network effects in many new economy industries and the possible "tipping" of such markets to a single product or standard, should time horizons used to define the market and assess the likelihood of entry be shortened?

Comments: The legislative history of the Antitrust Modernization Commission Act indicates a particular desire for Commission review of this set of issues. There is, moreover, a concern among some constituencies — founded or unfounded — that antitrust law (from a substantive perspective) may sometimes reach mistaken results for failure to account adequately for these considerations. There is no consensus, however, that existing antitrust standards need to be changed, and many observers believe they do not. *See generally* Robert Pitofsky, Antitrust and Intellectual Property: Unresolved

Issues at the Heart of the New Economy, Remarks at the Berkeley Center for Law and Technology's Antitrust, Technology, and Intellectual Property Conference (Mar. 2, 2001) (suggesting that antitrust policies have been adjusting to take into account the new economy), *available at* http://www.ftc.gov/speeches/pitofsky/ipf301.htm; Federal Trade Commission, *Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace* (1996), *available at* http://www.ftc.gov/opp/global/report/gc_v1.pdf. Nevertheless, the Working Group recognizes that interest in this issue is widespread, believes that the issue merits full Commission study, and concurs with the recommendation of the Intellectual Property Working Group to study similar issues.

2. **Should the Robinson-Patman Act be repealed in whole or in part, or otherwise be modified?**

The Robinson-Patman Act generally prohibits price discrimination. Generally, the Act makes it unlawful for any person

> to discriminate in price between different purchasers of commodities of like grade and quality . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . . .

Robinson-Patman Act § 2(a), 15 U.S.C. § 13(a). It has been identified by many observers as a law whose time has passed and which is inconsistent with the overall pro-competition objectives of the antitrust laws.

In particular, although Robinson-Patman Act plaintiffs must show competitive injury, the Supreme Court has held that Section 2(a) "was intended to justify a finding of injury to competition by a showing of 'injury *to the competitor* victimized by the discrimination.'" *FTC v. Morton Salt Co.*, 334 U.S. 37, 49 (1948) (quoting S. REP. NO. 1502, at 4 (1936)) (emphasis added). Therefore, where the plaintiff customer/reseller claims discrimination ("secondary line" injury), it can establish a rebuttable inference of competitive injury merely by showing that the defendant seller charged a substantially lower price over time to resellers competing with the plaintiff. *Id.* (In contrast, where the discrimination allegedly injures competitors of the discriminating seller — "primary line" injury — the required showing of competitive injury is similar to that imposed on predatory pricing claims under Section 2 of the Sherman Act. *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).) The Act does contain some limitations. In particular, Section 2(b) provides a limited cost-justification defense as well as a meeting-competition defense, with the latter allowing a defendant to show that the pricing "was made in good faith to meet an equally low price of a competitor." 15 U.S.C. § 13(b).

The Robinson-Patman Act has received "long-lived and unrelenting criticism" from many quarters for its failure to focus on competitive harm and protecting consumers and for its potential to stifle price competition. Herbert Hovenkamp, *The Robinson-Patman Act and Competition: Unfinished Business*, 68 ANTITRUST L.J. 125, 130 & n.15 (2000). The long list of critics includes previous commissions studying the antitrust laws, enforcement agencies, the antitrust bar, and numerous scholars. *See, e.g.*, *Report of the Attorney General's National Committee to Study the Antitrust Laws* 155-221 (1955); U.S. Department of Justice, *Report on the Robinson-Patman Act* (1977); ABA ANTITRUST SECTION, MONOGRAPH NO. 4, THE ROBINSON-PATMAN ACT: POLICY AND LAW, VOLUME I (1980); Hovenkamp, *supra*. The Act's defenders point out that the Act was intended to protect small businesses, rather than to serve efficiency concerns or to protect consumers. They argue that the Robinson-Patman Act as currently applied properly advances this purpose.

One suggested approach might be to recommend repeal of the statute outright. An alternative approach would be to focus on certain provisions of the Act that could be repealed even if the main provisions of the Act were to remain. In particular, Sections 2(c), 2(d), 2(e), and/or the criminal price discrimination provisions of 15 U.S.C. § 13a could be repealed separately. Section 2(c) prohibits anyone "engaged in commerce . . . to pay or grant, or to receive or accept, anything of value as a commission, brokerage, or other compensation . . . except for services rendered in connection with the sale or purchase of goods, wares, or merchandise." 15 U.S.C. § 13(c). This provision generally is designed to ensure that price discounts are not hidden through the use of commission payments (or reductions); it is especially problematic from the perspective of critics of the Act, however, because even the limited defenses available under Section 2(a) are unavailable to claims under Section 2(c). Sections 2(d) and 2(e) bar the payment for advertising, promotional allowances, or similar services unless offered on "proportionally equal terms" to all customers. 15 U.S.C. § 13(d)-(e). Finally, Section 3 of the Act imposes criminal liability for price discrimination and for selling goods at "unreasonably low prices" in order to destroy competition or eliminate a competitor. 15 U.S.C. § 13a. (The Working Group concurs in the Criminal Procedure and Remedies Working Group's recommendation to study the criminal provisions of the Robinson-Patman Act.)

A third alternative, if the statute is retained in whole or in part, would be to modify the statute by, for example, overturning *Morton Salt* and requiring a showing of injury to competition similar to that required under the Sherman Act.

Comments: There is a widespread consensus that the Robinson-Patman Act warrants a fresh look and potential reconsideration. The range of issues are potentially of great significance to the national economy and merits careful review, fact-finding, and analysis.

3. **Should the substantive standards for determining whether conduct is exclusionary or anticompetitive under either Section 1 or Section 2 of the Sherman Act be revisited?**

The standard for determining when conduct is exclusionary or anticompetitive can vary depending on the type of conduct. In addressing this question, the Commission would seek to consider and address a broad array of substantive questions, including the following: a) Should the standard for single-firm conduct move closer to the standard for abuse of a dominant position utilized in Europe? b) Should existing U.S. prohibitions on single-firm conduct be relaxed? c) Did *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), go too far in allowing dominant firms to extend power into adjacent markets through refusals to deal? Conversely, should unilateral refusals to deal ever be prohibited? d) Should tying doctrine be revised or clarified — for example, so that it is defined legislatively as a Rule of Reason offense? e) What is the correct treatment of bundling and discounting programs? Is a separate standard needed for zero (or low) marginal cost industries?

Comments: These are all important issues of fundamental doctrine. The appropriate standard for determining whether unilateral conduct is or is not exclusionary has been the subject of extensive debate, and no consensus is in sight. *Compare* Reply Brief for Appellant, *United States v. Dentsply Int'l, Inc.*, *appeal docketed*, No. 03-4097 (3d Cir. May 14, 2004), *and* Brief for the United States and the Federal Trade Commission as *Amici Curiae* Supporting Petitioner, *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (No. 02-682), *with* 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 651a (2d ed. 2002), *and Aspen Skiing Co. v.*

Aspen Highlands Skiing Corp., 472 U.S. 585 (1985). The recent decision in *Trinko* — while expressly limiting the reach of *Aspen* in the duty-to-deal context — neither accepted nor rejected the "sacrifice test," the "unnecessarily restrictive" test, the balancing test, or any other formulation.

Many observers believe that the lack of consensus on the appropriate legal standards for exclusionary conduct generally poses an obstacle to U.S. businesses in deciding what they can or cannot do. The standards governing tying, exclusive dealing, bundled pricing, and other vertical practices are particularly unclear. *See generally* Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 ANTITRUST L.J. 3 (2004). Few matters can be more important in antitrust than the general standards for evaluating unilateral and vertical conduct. Yet, the lack of clarity in this area of law means that businesses must make decisions either to forego practices that would improve their competitive standing (and benefit consumers) or to engage in conduct that may embroil them in years of costly litigation. The articulation of clear standards could provide substantial benefit to businesses and the economy, and the Commission's work could assist enforcement agencies and the courts in clarifying current law.

There is, however, a contrary view that would recommend that the Commission decline to entertain these difficult substantive issues. First, the issues in question are part of the development of the common law process of antitrust decision-making. The fact that there is some uncertainty is neither unusual nor necessarily undesirable. The uncertainty may be attributable to a lack of consensus as to the appropriate standard, and, if there is no consensus, there is arguably no great warrant for Commission intervention.

Second, the common law process generally has been effective, and it is uncertain whether the Commission could contribute significantly to the process of common law development. The common law, informed by academic and other commentary, will likely develop appropriate answers to these questions over time. Finally, given the Commission's limited resources and time, the work that it does should be designed to promote the long-term betterment of the antitrust laws. Analyzing areas such as these runs a high risk that, viewed from the greater legal and economic wisdom the future may bring, the significance of the Commission's findings may be short-lived. (Consider, by way of example, the changes in tying doctrine over time. *Compare Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912), *with Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984), *with United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir.), *cert. denied*, 534 U.S. 952 (2001).)

On balance, having considered these pros and cons, a majority of the Working Group recommends that the Commission review and report on these issues.

4. **Should there be a new statute that would prohibit covert unilateral solicitations of competitors to fix prices, rig bids, divide territories, or allocate customers?**

Absent a solicitation in a duopoly market, the only vehicle to address a unilateral solicitation to fix prices (or to engage in any other *per se* offense) under the antitrust laws is Section 5 of the FTC Act, 15 U.S.C. § 45, for which the only remedy is a cease and desist order, *see United States v. American Airlines, Inc.*, 743 F.2d 1114 (5th Cir. 1984) (holding that "an agreement is not an absolute prerequisite for the offense of attempted joint monopolization"). In addition, the wire (or mail) fraud statutes may be available to prosecute many such unilateral solicitations. *See, e.g.*, *United States v. Ames Sintering Co.*, 927 F.2d 232 (6th Cir. 1990) (phone solicitations to rig bids). The fines generally available under the wire or mail fraud statutes, however, may not be as large as those available under the Sherman Act. *Compare* 18 U.S.C. § 3571(c)(3) (generally permitting fines of $500,000 for felonies, including wire or mail fraud) *with* 15 U.S.C. §§ 1-3 (permitting fines of up to $100 million for certain antitrust offenses). *But see* 18 U.S.C. §3571(d) (permitting fines of double the gain or loss for felonies, including wire or mail fraud, in certain circumstances).

> *Comments*: Adding a new provision to the Sherman Act would allow for more aggressive prosecutions of unsuccessful attempts to form cartels. There is a strong consensus that "naked" collusion merits the strongest antitrust sanction. Prosecuting attempts to collude is consistent with that objective. As is true in regard to any criminal statute, the sound exercise of prosecutorial discretion should ensure that such a statute is sought to be applied in only the most clearly appropriate cases, and that it would not be used against "non-naked" solicitations to enter into a legitimate joint venture or other form of competitor collaboration, which would normally be assessed under the Rule of Reason. The number of instances where even the most serious solicitations have been "under-prosecuted" may not be significant, however, which may suggest the absence of a statute is of little consequence. On balance, a majority of the Working Group believes that the question merits Commission study.

5. **Should the antitrust laws be clarified so that they reach, or reach more effectively, exercises of buyer power?**

As noted recently by the FTC and DOJ, buyer power has become a source of serious competitive concern and is an issue deserving further study. *See* Federal Trade Commission & U.S. Department of Justice, *Improving Health Care: A Dose of Competition*, ch. 6 (July 2004), *available at* http://www.usdoj.gov/atr/public/health_care/204694.pdf. Specific questions the Commission could address include: How should economies of scope be analyzed in the context of monopsonies? Does the fact-specific nature of monopsony cases make general standards (*e.g.*, market share thresholds) inappropriate? Should firms be permitted to acquire or exercise countervailing monopsony power when they face monopoly power (or *vice versa*)?

Comments: Although some commenters argue that monopsony cases can be treated analogously to monopoly cases, there is no consensus on how monopsony issues should be analyzed. *Compare, e.g.*, David Balto, Punishing Monopsony Without Proving Consumer Harm?, Remarks at the Sedona Conference (Nov. 20-21, 2003), *and Monopsony Issues in Agriculture: Buying Power of Processors in Our Nation's Agricultural Markets*, Hearing before the Senate Judiciary Comm., 108th Cong. 58 (2003) (Statement of Peter C. Carstensen, Law Professor, University of Wisconsin Law School), *available at* http://judiciary.senate.gov/testimony.cfm?id=975&wit_id=2782, *with* Jonathan M. Jacobson & Gary J. Dorman, *Monopsony Revisited: A Comment on Blair & Harrison*, 37 ANTITRUST BULL. 151 (1992). Accordingly, the Commission could usefully add its insights to improve understanding of this issue.

Issues not recommended for study

The Working Group recommends that the Commission not study the following issues:

6. **What are appropriate standards for defining markets in merger cases, Rule of Reason cases, and monopolization cases? Should market definition continue to be an essential element of the proof in cases where significant market power can be demonstrated through more direct methods? If not, should Clayton Act Section 7 and Sherman Act Section 2 be amended accordingly?**

The purpose of market definition is to determine power, but if power can be determined and measured directly there may be little or no reason — apart from the text of Clayton Act Section 7 and Sherman Act Section 2 — to engage in the market definition process. Even where market definition is necessary or appropriate, questions arise as to the proper methodology for defining markets. A number of observers have questioned the practical value of the prevailing hypothetical monopolist paradigm, but there is no consensus on whether that test should be replaced or what any replacement test might be.

> *Comments*: Antitrust analysis requires an accurate assessment of market power and, if the existing tools used to assess market power are not doing the job, they should be revised. Recent court decisions demonstrate confusion in analyzing market definition and market power, and there appears to be a consensus that the agencies too are inconsistent in their analyses. To the extent the Commission can recommend improvements in the analysis, it could provide a significant public benefit. Moreover, if there is a need to recommend statutory changes to the text of Section 7 of the Clayton Act ("line of commerce"; "section of the country") or Section 2 of the Sherman Act ("part" of commerce) to eliminate a strict market definition requirement, that responsibility falls squarely within the Commission's charter.
>
> Despite the importance of market definition and market power issues in antitrust analysis, some believe that Commission review of these issues would not be of any significant practical benefit. Examination of market power is necessary in all cases not involving the most naked restraints, yet neither the current state of the law nor the current state of economics provides any flawless mechanism for analyzing power. A market definition requirement, at least, begins to focus the decision-maker on the correct set of questions. And the processes for determining markets, flawed as they may be, nevertheless tend to generate sound practical outcomes. It is unclear that Commission study in this area would generate any practical solution to these difficult issues that the courts and agencies will not develop on their own anyway.

Having considered these competing views, a majority of the Working Group recommends that these aspects of market definition not be studied by the Commission.

7. **Should the primary-line aspects of Section 2(a) of the Robinson-Patman Act and the provisions of Section 3 of the Clayton Act be repealed as duplicative?**

Section 3 of the Clayton Act, 15 U.S.C. § 14, and the primary line liability aspects of 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a), arguably add little or nothing of substance to the Sherman Act. But the possibility that the standards *might* be different occasionally creates unnecessary confusion. Proposals have therefore been made to repeal these provisions largely as a housekeeping measure, eliminating unnecessary clutter, confusion, and redundancy.

Comments: There are valid reasons for considering these issues and, if the Commission's agenda were not otherwise so full, these issues would be strong candidates for review. Unlike the issue of the Robinson-Patman Act as a whole, however, there is a fair question whether the continued retention of the terms of Section 3 of the Clayton Act and/or primary-line Robinson-Patman liability is likely to cause any real harm. If not, the Commission's time might be spent more effectively on other matters. Were these provisions to be repealed, one concern would be to ensure that any such repeal not be construed as changing substantive standards for tying, exclusive dealing, or predatory pricing — or even rendering them *per se* legal, as tying and exclusive dealing effectively were prior to enactment of the Clayton Act.

8. **Should Section 8 of the Clayton Act (interlocking directorates) be repealed or modified?**

A number of observers of antitrust enforcement over the years have recommended a fresh look at whether there is any continued need for Section 8, 15 U.S.C. § 19.

Comments: Section 8 arguably goes too far in addressing what might, on close empirical analysis, be a minor competition problem, especially since the conduct of interlocked corporations and their common directors is itself subject to Section 1 of the Sherman Act. Conversely, however, repeal might well permit anticompetitive interlocks in circumstances where proof of anticompetitive harm would be difficult. Repeal, moreover, might lead to a great increase in the number of interlocks, with potentially harmful consequences it may be difficult now to predict. If Section 8 issues are to be considered, the Commission would appropriately also review the question whether Section 8 operates only with respect to *individuals* who serve on the boards of competing corporations meeting the statutory dollar thresholds or whether the word "person" in the statute applies as well to corporations and their designees (the deputization approach). Most recent decisions have endorsed the deputization approach, but the issue is not settled. *See SCM Corp. v. FTC*, 565 F.2d 807, 811 (2d Cir. 1977); *Reading Int'l, Inc. v. Oaktree Capital Management, LLC*, 317 F. Supp. 2d 301, 326-31 (S.D.N.Y. 2003); *Square D Co. v. Schneider*, 760 F. Supp. 362, 367 (S.D.N.Y. 1991).

9. **Should resale price maintenance be defined legislatively as a Rule of Reason offense?**

If the Commission addressed resale price maintenance ("RPM"), it could also consider whether it would be appropriate to pass legislation that would overrule the Supreme Court's holding in *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), so that the termination of a discounter *because* of its discounting is unlawful whether or not there is agreement on a specific price or price level. Addressing this question would also entail review of empirical research, as well as possible additional original research, regarding the impact of vertical restraints.

Comments: The proper treatment of RPM is an issue of great historic importance in antitrust. Today, however, it may be less important than ever before. The *Sharp* case has quieted to some extent the views of those clamoring for Rule of Reason treatment because, under *Sharp*, the level of proof required for a plaintiff to establish a *per se* violation is extremely high. On the other side, there are a number of observers who would favor greater enforcement in this area.

RPM is an area of antitrust where the argument for the Commission to defer to the common law process is especially powerful, as its common law history to date attests. RPM was largely unknown, but generally permitted, by the pre-Sherman Act common law, although it was generally viewed as unlawful in the scant Sherman Act legislative history on the subject. The Supreme Court condemned RPM as *per se* illegal at its first opportunity to do so, *see Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), but its recognition of a broad unilateral right to refuse to deal in *Colgate* a few years later made RPM claims much more difficult to establish. *See United States v. Colgate & Co.*, 250 U.S. 300 (1919). The Supreme Court later limited the protections afforded by *Colgate* in *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960). Federal law enabled states to provide protection for RPM through Fair Trade laws, but this was repealed in 1975. *See* Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801 (1975).

More recently, DOJ sought to advocate that the Supreme Court end the *per se* rule in 1983 in *Monsanto Co. v. Spray-Rite Services Corp.*, 465 U.S. 752 (1984), but Congress cut off DOJ funding to advance that argument and the Supreme Court upheld the *per se* rule. Finally, in *Business Electronics Corp. v. Sharp Electronics Corp.*, 485

U.S. 717 (1988), the Court placed arguably the greatest burden on plaintiffs bringing RPM claims on *per se* theories — holding that *per se* illegal treatment is appropriate only if plaintiff establishes that there was an agreement on a specific price or price level. The shifting approaches over time to RPM, along with a relatively low level of controversy on the subject, strongly suggest that the Commission stand aside and let the common law process work.