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UNITED STATES FEDERAL TRADE COMMISSION

and

UNITED STATES DEPARTMENT OF JUSTICE

SHERMAN ACT SECTION 2 JOINT HEARING

UNDERSTANDING SINGLE-FIRM BEHAVIOR:

MONOPOLY POWER SESSION

WEDNESDAY, MARCH 7, 2007

HELD AT:

UNITED STATES FEDERAL TRADE COMMISSION

601 NEW JERSEY AVENUE, N.W.

WASHINGTON, D.C.

9:30 A.M. TO 4:30 P.M.

Reported and transcribed by:

Susanne Bergling, RMR-CLR

1 MODERATORS:

2

DENNIS W. CARLTON

3

Deputy Assistant Attorney General for Economic Analysis

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Antitrust Division, Department of Justice

5

and

6

JOEL L. SCHRAG

7

Economist

8

Bureau of Economics, Federal Trade Commission

9

10 PANELISTS:

11

12 Morning Session:

13

Andrew J. Gavil

14

Richard J. Gilbert

15

Michael L. Katz

16

Philip B. Nelson

17

Joseph J. Simon

18

Lawrence J. White

19

20 Afternoon Session:

21

Simon Bishop

22

Thomas G. Krattenmaker

23

Miguel de la Mano

24

Joe Sims

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Irwin M. Stelzer

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

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3 MR. SCHRAG: Good morning. Sorry about the  
4 technical issues. Welcome.

5 My name is Joel Schrag. I am an economist at  
6 the Bureau of Economics here at the Federal Trade  
7 Commission, and I am one of the moderators for this  
8 panel. My co-moderator, standing next to me, is Dennis  
9 Carlton, Deputy Assistant Attorney General for Economic  
10 Analysis at the Antitrust Division of the Department of  
11 Justice.

12 Before we get into the substance of the program,  
13 on behalf of the FTC staff who have worked on this  
14 session, I would like to take the opportunity to thank  
15 all of our colleagues from DOJ for their hard work and  
16 their efforts to jointly present this session.

17 In addition, after today's and tomorrow's  
18 hearings on monopoly power, the hearings will next turn  
19 to issues involving remedies later this month, and so I  
20 urge you all to be sure to check our agencies'  
21 respective web sites for updates on these future  
22 hearings.

23 As the FTC representative, I do have just a few  
24 housekeeping matters to cover before we begin. First of  
25 all, please turn off all of your cell phones,

1     BlackBerries and other noise-making electronic devices.  
2     Second, the restrooms are located out through the double  
3     doors and across the lobby. If you need help to find  
4     them, there are signs that should guide you.

5             Third, one safety tip, especially for visitors,  
6     in the unlikely event that the building alarms go off,  
7     please proceed calmly and quickly as instructed. If we  
8     must leave the building, you exit out the New Jersey  
9     Avenue doors by the guard station. Please follow the  
10    stream of FTC employees to a gathering point across the  
11    street and await further instruction, but hopefully that  
12    won't be necessary.

13            Finally, we request that you please not make  
14    comments or ask questions during the session. Thank  
15    you.

16            Let me just say a few things about the session.  
17    Many of the prior sessions of the hearings addressed  
18    particular conduct that's been challenged under Section  
19    2 of the Sherman Act. Today, the hearings turn to  
20    issues of monopoly power and market definition, and  
21    these issues we believe are very important.

22            In fact, if you were at the opening day of the  
23    hearings back in June, both Herbert Hovenkamp and my  
24    co-moderator, Dennis Carlton, were given the opportunity  
25    to place the issues for the subsequent hearings in

1 context. Both identified monopoly power and market  
2 definition as areas where there are difficult, uncertain  
3 questions that must be addressed in many cases, and I  
4 expect that today's panel will help to clarify, if not  
5 completely resolve, these difficult questions.

6 The hearings will be organized as follows:  
7 First, we'll hear an approximately 15-minute  
8 presentation from each of our six distinguished  
9 panelists. We'll probably take a break after the fourth  
10 panelist and then come back from the break and hear from  
11 the two remaining panelists. After that, the panelists  
12 will have an opportunity to comment on each other's  
13 presentations, and we'll have a moderated discussion.

14 So, I think I'd now like to turn things over to  
15 my co-moderator, Dennis Carlton, who will introduce our  
16 distinguished panelists.

17 Thank you very much.

18 DR. CARLTON: Okay, thank you. I am Dennis  
19 Carlton. I am a Deputy Assistant Attorney General in  
20 the Antitrust Division, and it is a pleasure to welcome  
21 all of you to these joint FTC/DOJ hearings.

22 I had the privilege of participating in the  
23 opening session of the hearings, and one of the topics I  
24 said that needed clarification was precisely the topic  
25 of the panels today and tomorrow, a focus on what we

1 mean by "market power" and "market definition" in  
2 Section 2 cases I think is really important.

3 I am also a Commissioner on the Antitrust  
4 Modernization Commission, and despite my attempting to  
5 do so was not able to convince the Commission to study  
6 in depth the definition of market power and market  
7 definition in Section 2 cases and to report on it. So,  
8 that, I think, emphasizes all the more how important  
9 this session, this panel discussion, is today, and the  
10 real question is, can we reach consensus on any of the  
11 hard questions or at least can we reach a consensus that  
12 there's a lot of ambiguity and arbitrariness in what is  
13 going on?

14 I am honored to chair such a distinguished  
15 panel. All of the members of the panel have extensive  
16 experience, both academic and nonacademic, in antitrust  
17 and have served both in the private sector and in the  
18 government sector.

19 In the interest of saving time, I am going to  
20 introduce them all at once and hopefully by that time  
21 the computer will work. So, starting with Phil, Phil  
22 Nelson is a principal at Economists, Inc., an economic  
23 consulting firm. Previously, he served as the Assistant  
24 Director for Competition Analysis at the FTC and as an  
25 Adjunct Professor at Fordham Law School. He has written

1 numerous articles and two books on antitrust topics, and  
2 he edited the ABA's antitrust section of market power --  
3 The Market Power Handbook. He currently is the  
4 vice-chair of the section's Healthcare and  
5 Pharmaceuticals Committee.

6           Beside Phil is Joe Simons. Joe is a well-known  
7 attorney. He's a partner and co-chair of the antitrust  
8 group at Paul Weiss. Previous to that, Joe was the  
9 chief antitrust enforcer at the Federal Trade  
10 Commission, serving as the Director of the Bureau of  
11 Competition from June 2001 until August of 2003. He has  
12 the interesting characteristic of once being the tenth  
13 largest wireless carrier in the country, because I  
14 believe he was a trustee and had a lot of wireless  
15 licenses, but in addition to that, he has achieved  
16 something that's actually quite rare for attorneys to  
17 do, and that is he's written an article that economists  
18 cite all the time and is associated with critical loss  
19 analysis.

20           Beside Joe, in a missing seat, is Larry White,  
21 who I am sure is on his way. Larry is the Arthur  
22 Imperatore Professor of Economics at NYU School of  
23 Business. He's the Deputy Chair of the Department of  
24 Economics. Previously, in the early eighties, Larry  
25 served as the Director of the Economic Policy Office in



1 the Antitrust Division. Larry has written several books  
2 and articles, one of which is well-known to antitrust  
3 practitioners called The Antitrust Revolution:  
4 Economics Competition and Policy. He's currently the  
5 editor of The Review of Industrial Organization. Prior  
6 to serving at the Justice Department, he did extensive  
7 government service both for the Federal Home Loan Bank  
8 Board and for the Council of Economic Advisers.

9           Andy Gavil is a Professor of Law at Howard  
10 University where he not only teaches antitrust, but he  
11 has also extensively written on antitrust many articles  
12 and has a very well-known case book with Bill Kovacic  
13 and Jonathan Baker, Antitrust Law in Perspective. He is  
14 about to publish or co-author a book called Microsoft  
15 and the Globalization of Competition Policy, which I am  
16 sure has focused on Section 2 type behavior. He's  
17 currently the articles editor of The Antitrust Magazine  
18 and serves on the ABA Antitrust Section's Liaison Task  
19 Force to the Antitrust Modernization Commission. He is  
20 Of counsel to the Sonnenschein Law Firm.

21           To Andy's left is Rich Gilbert. Rich is a  
22 Professor of Economics at the University of California  
23 at Berkeley. He served as the Deputy Assistant Attorney  
24 General in the Antitrust Division in the mid-nineties,  
25 and at that time, he led the effort to write the

1 Antitrust Guidelines for the Licensing of Intellectual  
2 Property. He has written widely on antitrust topics.  
3 He is currently the Director of the Competition Policy  
4 Center at Berkeley and is associated with the economic  
5 consulting firm of COMPASS.

6 Finally, Mike Katz at the end of the table.  
7 Mike is currently the holder of the Sarin Chair in  
8 Strategy and Leadership at Berkeley, the Business  
9 School, and also holds an appointment in the Economics  
10 Department. Mike served as the Deputy Assistant  
11 Attorney General in the early 2000s, and he also served  
12 as the Chief Economist at the Federal Communications  
13 Commission. He's written numerous articles on economics  
14 and antitrust and has specialized in many topics,  
15 including network industries.

16 So, with that introduction, I'll turn it over to  
17 our first speaker, Phil, and just let me remind the  
18 speakers, we're kind of running tight because we started  
19 late, so if you could keep to the 15 minutes, that would  
20 be good. The organization of this is going to be four  
21 speakers will go, 15 minutes, we'll take a 10-minute  
22 break, we'll have two more speakers. We will give the  
23 speakers a brief opportunity to talk to each other, and  
24 then I'll moderate a discussion for about an hour or so.

25 Thank you.

1 MR. NELSON: So, we have a -- are we moments  
2 away or should I just proceed without slides?

3 DR. CARLTON: Is the computer still not working?

4 MR. NELSON: Well, okay, the reason they put me  
5 first is the slides that you can't see are really sort  
6 of a background deck that gives you the background on  
7 market power. The first slide cites the definition of  
8 market power that's at the front of the monograph that  
9 the ABA published that was referred to earlier, which is  
10 market power is the ability of a firm or a group of  
11 firms within a market to profitably charge prices above  
12 the competitive level for a sustained period of time,  
13 and as you can't see on the screen, the word  
14 "profitably" is in italics, and so one of the important  
15 things in the definition is that a monopolist profit by  
16 doing this.

17 If entry is easy, you may be able to raise  
18 prices, but not profitably, because somebody will enter,  
19 and if there are a lot of competitors, they can steal  
20 customers away from you, so you can't profit. That may  
21 become of importance in some of the discussion as to  
22 what type of performance evidence one might use in  
23 determining whether a firm has market power or not.

24 A price above the competitive level, the  
25 "competitive level" was in italics, because people talk

1 about the standard monopoly raising prices, and if you  
2 are not raising them above the competitive level,  
3 usually people don't care.

4 Then a "sustained period of time" is in the  
5 definition because you may be able to opportunistically  
6 raise prices for a little bit, but again, entry or  
7 something might undermine the ability to do that.

8 Now, in some of the legal cases, you see  
9 reference to the ability to exclude competition, and I  
10 will suggest that is something worth consideration,  
11 because in some contexts -- and there were FTC hearings  
12 many years ago about standard-setting organizations  
13 where there might be a collection of, let's say, 10 or  
14 more people making a particular product, and there might  
15 be enough competitors that they compete and charge a  
16 competitive price because there's so many people  
17 operating under that standard.

18 Well, somebody may develop a new technology that  
19 would come in and completely take the market away from  
20 the incumbent competitors with the older technology.  
21 Acting jointly in that case, they might be able to block  
22 entry by controlling the standard-setting organization.  
23 Are they raising prices above the competitive level?  
24 They're excluding an entrant, somebody that would  
25 dynamically help the market with a new technology that

1 might have better performance characteristics and be  
2 able to be sold at a lower price. What they get out of  
3 it is where their profit is, is that they get to earn  
4 the competitive rate of return rather than being maybe  
5 in bankruptcy court.

6           So, while I gave you the standard definition,  
7 there are other things and other contexts, as you can  
8 see from the get-go, that you have to worry about in  
9 deciding whether a firm or a group of firms have market  
10 power. And today, largely we'll focus on dominant  
11 firms, but there are contexts where a group of firms  
12 acting together might have trouble. And if a dominant  
13 firm has control over a patent that's a blocking patent  
14 that blocks a new technology, he might have an interest  
15 in blocking the new technology just like the group of  
16 firms that ran the standard-setting organization has an  
17 incentive to block technology. So, that's one thing.

18           The other thing that I wanted to highlight at  
19 the beginning is, some people talk about market power;  
20 some people talk about monopoly power. Often,  
21 economists mean the same thing, but in some contexts,  
22 people have defined them differently. Greg Werden is  
23 sitting there, and he's drawn a distinction in one of  
24 his articles and alludes to other people that  
25 distinguish market power and monopoly power perhaps in

1 terms of the time period over which people have the  
2 ability to raise prices and the like.

3           There are articles out there that talk about  
4 antitrust monopoly power, again, trying to make a  
5 distinction. And there, often the thought is if you  
6 have a differentiated product and thus have a  
7 downward-sloping demand curve for your product, you  
8 might have some degree of ability to raise prices above  
9 costs and you might in that sense have market power, but  
10 you might not have a substantial ability to do it.  
11 Because there are a lot of products out there that are  
12 roughly close substitutes, not exactly the same thing,  
13 and you might in that context have some market power but  
14 not antitrust monopoly power or antitrust market power,  
15 because you don't really have substantial ability to  
16 earn substantial profits and the like. So, some people  
17 try to distinguish that downward-sloping demand curve  
18 idea by talking about antitrust monopoly power.

19           I think with that background, we're talking  
20 about antitrust market power. Something that's somewhat  
21 significant. And then different panelists may have  
22 different degrees of market power in mind when deciding  
23 how you go about measuring whether it is significant  
24 enough market power. So, with that sort of definition  
25 of market power, the next slide was going to lay out

1 sort of the touchstones in a typical market power proof  
2 that you sort of run through, and the first thing people  
3 often define is product market definition. Then they go  
4 to defining geographic market definition.

5           Once you have a relevant product/geographic  
6 market combination, often it is standard to look at  
7 market concentration in a monopoly case, and once you  
8 clear that hurdle and see that maybe it is substantially  
9 concentrated or a firm has a dominant market share, a  
10 high-level market share, you then start looking at  
11 things like entry conditions, other structural  
12 characteristics of the market. Maybe you look at in  
13 some contexts, you know, the structure of the buyer-side  
14 of the market, and if it is a collusion case type of  
15 monopoly power issue, maybe you look at the  
16 characteristics of the market that make it easier or  
17 harder for firms to collude in that market.

18           Then finally, in a lot of the monopolization  
19 cases, you see a consideration of market performance  
20 evidence, and that's where you start having things like  
21 profit rates of return, profit margins, looking at  
22 prices over time or across geographic areas. You look  
23 at output patterns and how they vary with prices. And  
24 you look at new product introductions. You can either  
25 look at them in terms of formal econometric analysis or

1 often you look at events -- market events that allow you  
2 to sort of control for some things -- and look at how if  
3 the events give you insights either directly into the  
4 market power or at some of the related issues like  
5 market definition.

6 Now, increasingly, because of the success of the  
7 Merger Guidelines, you see references to the approach  
8 used in the Merger Guidelines of developing a relevant  
9 market in the context of monopolization cases, and there  
10 were a couple slides that sort of just quoted the  
11 Guidelines. I suspect with this audience, there is no  
12 reason to go through it, but it is the hypothetical  
13 monopolist test. Can the monopolist raise prices above  
14 the -- in the Guidelines, they talk more or less about  
15 the current level as opposed to the competitive level  
16 and see if that's profitable.

17 Now, one thing that is worth pointing out,  
18 especially in transferring that concept, is that in the  
19 Guidelines themselves, Section 1.11 says that while you  
20 might look at prevailing prices in the Guidelines, there  
21 is a caveat that says if pre-merger circumstances are  
22 strongly suggestive of coordinated interaction, in that  
23 situation, the agency will use a price more reflective  
24 of the competitive price. So, there is a caveat in  
25 there where they don't always use prevailing prices.



1           One sort of footnote is that the original  
2 guidelines were focused on coordinated effects, and then  
3 they later on added more information about unilateral  
4 effects. I think there's a little glitch here, because  
5 I think the Merger Guidelines actually should make a  
6 reference not only to coordinated interaction, but also  
7 if the dominant firms raise prices above the competitive  
8 level, then you might want to look at the competitive  
9 price level.

10           Why might you want to do that? Well, that is  
11 because you get a different elasticity and different  
12 substitutes depending on at what price level you measure  
13 the substitution. And this is where the lack of slides  
14 really hurt us the most, because I put together an  
15 illustrative example of a demand curve with a concrete  
16 slope and all the rest, calculated the marginal revenue  
17 curve from that, showed where the competitive price  
18 would be, where basically price equals marginal cost,  
19 then showed where the monopolist would operate, which is  
20 at a higher price, and then estimated the elasticities  
21 of a couple of the different points along the demand  
22 curve.

23           What you see is that even though a demand curve  
24 is a straight line and thus the slope is constant over  
25 the whole curve, the elasticity changes. And at the

1 higher prices, the demand is more elastic. And, the  
2 reason that that makes sense is that a monopolist is  
3 going to keep raising its price, you know, and find a  
4 price that is more profitable. And in the monopolistic  
5 equilibrium, he has got a high enough price that demand  
6 becomes elastic and a further price increase would lose  
7 a lot of customers to other products. That is called  
8 the Cellophane fallacy -- that sets up the Cellophane  
9 fallacy, which is if you measure the elasticities at the  
10 monopoly price, you are going to run into problems  
11 because there are a lot of substitutes out there that  
12 are not substitutes at the competitive price. You can  
13 do all the econometrics you want and estimate the  
14 elasticities, but if you do not know whether you were at  
15 a competitive price or a monopoly price, that elasticity  
16 estimate does not tell you anything when you are doing a  
17 monopolization case particularly.

18 So, then you get into this tautological  
19 situation. If you think about the paradigm of starting  
20 with a monopoly case and saying, "Well, do I have a  
21 monopoly here?" And you have to define the market, and  
22 you have to define a monopoly price to define the  
23 market, then why bother defining the market? So, you  
24 have got a couple of issues here that suggest, what do  
25 you do about it? And the rest of my deck talks about

1 the sorts of things that one might look at. But, the  
2 basic thing that I wanted to suggest is -- while I think  
3 there are great problems with a simplistic analysis of  
4 the standard paradigm I outlined -- I think there are  
5 elements of it that, if you can go through it all, can  
6 help you in many circumstances unravel this thing and  
7 cross-check your conclusion.

8           So, it is a way of organizing your story.  
9 Making sure that you look at your story or your analysis  
10 as consistent, and that it gives you insights into what  
11 you might look at. And where it leads you, I think, is  
12 looking more and more at some of the performance  
13 evidence. But you have got to be careful in looking at  
14 the performance evidence, because as economists have  
15 shown, things like profits and accounting data are  
16 tricky.

17           Having said that, I also think that how  
18 difficult a problem it is varies a lot from market  
19 circumstance to market circumstance. I think it is  
20 probably trickiest when you are dealing with  
21 consumer-differentiated products, like Cellophane  
22 wrapping paper or something. It may be less of a  
23 problem when you are dealing with an input into an  
24 industrial process, where you can look at substitutes in  
25 a more maybe engineering approach type of way.

1           My time is basically up, so to keep us on  
2           schedule, I would recommend -- they are going to post  
3           the slides later on, and they are written in a way that  
4           they are readable -- so I suggest you look at the slides  
5           for the rest of the story.

6           Thanks.

7           (Applause.)

8           DR. CARLTON: Thank you.

9           Our next speaker is Joe Simons.

10          MR. SIMONS: Thanks, and good morning, everyone.

11          I would like to start out by complimenting the  
12          FTC and the Department of Justice in holding these  
13          hearings and doing a terrific job. I am really quite  
14          encouraged that something really valuable will come out  
15          of this.

16          So, one of the first things that happened this  
17          morning is the audience was instructed not to ask any  
18          questions or make any comments. So, I thought, well,  
19          gee, I was planning to hear you violate that restriction  
20          right away, but maybe we'll try something a little bit  
21          different.

22          Perhaps by a show of hands, who in here would  
23          say that the 1982 Department of Justice Merger  
24          Guidelines market definition paradigm was the most  
25          significant development in market definition in the last

1 30 years?

2 So, we have got most of the panelists and maybe  
3 half of the audience. That is pretty good for one  
4 thing. I would have expected it might have been a  
5 little bit higher.

6 But in any case, what that showing would  
7 demonstrate is an enormous amount of success for that  
8 effort, I think by any standard, and why is that the  
9 case? Why were those guidelines on the market  
10 definition paradigm so successful?

11 In my view, it is because those guidelines  
12 reflected an understanding that the tools of antitrust  
13 analysis should be designed for a specific purpose.  
14 Previously, you had market definition which was pulled  
15 out of the economics literature and it was not designed  
16 to do an antitrust analysis. The merger guidelines  
17 market definitions was done specifically for that  
18 purpose.

19 The other thing that was really important is  
20 that the agency, the DOJ in that case, was willing to be  
21 out in front of the case law. I think there was a  
22 pretty good argument that those guidelines, the market  
23 definition therein, did not really reflect the case law.  
24 So, I thought it would be useful to do a little case  
25 study and talk about first principles and market

1 definition.

2 The Guidelines, the Merger Guidelines, were  
3 built around the goals defined right in the Guidelines  
4 of preventing mergers from creating or increasing market  
5 power -- initially through coordinated interaction and  
6 then later unilateral effects. And as I said, they  
7 geared this market definition specifically to this  
8 overall goal of the Merger Guidelines. So, it was  
9 designed to identify that universe of firms that were  
10 necessary to profitably engage in coordinated  
11 interaction or in unilateral effects. Then for the  
12 unilateral effects, arguably the analysis could collapse  
13 the market definition into the competitive effects  
14 analysis. The market definition in the Guidelines is  
15 rigorous, it is logical, and it is transparent.

16 Now, sitting here today, 25 years later, and  
17 seeing what a success this was, you might forget what it  
18 was like when these things were first issued. There  
19 were hoots and howls from all sectors of the Antitrust  
20 Bar and the academic community. These guidelines were  
21 ivory tower nonsense; they were completely hypothetical;  
22 they were totally inoperable and just downright  
23 impractical; a complete waste of time. These were  
24 comments that people made very regularly, and some  
25 people even said it was a conspiracy to do away with the

1 antitrust laws.

2           There was a little bit of a kernel of truth to  
3 some of those complaints, not the conspiracy stuff, but  
4 to the practicality of this test. There were a lot of  
5 people who saw the initial attempts to implement this by  
6 the agencies in the following way. One of the staff  
7 lawyers would have a conversation with the customers and  
8 say, "Gee, do you think that the sellers in this market  
9 could profitably raise price 5 or 10 percent?" You are  
10 shaking your head, but I heard people do that, Greg, and  
11 the customer has no concept of what it takes for it to  
12 be profitable. There is no context to the question.  
13 So, there were reasonable criticisms.

14           But what happened is that because the algorithm  
15 was rigorous and logical and transparent, it enabled the  
16 development of applications basically, tools, to  
17 implement this approach, econometric tools. Examples  
18 are Baker and Bresnahan and Scheffman and Spiller, Greg  
19 Werden as well, something near and dear to me, critical  
20 loss. These things did not exist when those guidelines  
21 were first issued, and that really was an important  
22 lesson to learn, that if you have the right structure,  
23 then you have created a platform on which you can build  
24 something that really works.

25           So, what does this translate into in terms of

1 what we should do for section 2? Well, what are the  
2 goals of section 2? What are we trying to accomplish?  
3 Is there a consensus? You know, there has been a lot of  
4 ink been spilled in relation to the Trinko case, for  
5 example. There are differences already between the way  
6 the DOJ and the FTC look at this. There is the profit  
7 sacrifice test, the no economic sense test; there is the  
8 disproportionate harm relative to efficiencies test.

9 So, where does that leave us for market  
10 definition? Does that create a problem? Can we rely on  
11 what is in the case law? Reasonable interchangeability,  
12 what does that mean? How much interchangeability is  
13 reasonable? It is basically relying on  
14 cross-elasticities of demand. How high does the  
15 cross-elasticity have to be? Is that even something you  
16 can look at? Can we rely on the Merger Guidelines  
17 market definition? Does the hypothetical monopolist  
18 paradigm, as applied in the Merger Guidelines, really  
19 work for section 2? And one of the issues in section 2  
20 is, are we focused on the same phenomenon that we are  
21 for section 7?

22 The Merger Guidelines, the Horizontal Merger  
23 Guidelines, are basically focused on collusion, an  
24 extreme form of which is unilateral behavior. So you  
25 are talking about situations in which a group of firms



1 is trying to restrict their own output, whereas in  
2 section 2, what you are dealing with is a situation in  
3 which one firm, the large firm, the dominant firm, is  
4 trying to restrict the output of somebody else in most  
5 cases and maybe sometimes themselves as well. So, what  
6 do we do with all of that?

7 One possible thing to do -- and I am just  
8 throwing this out -- would be to come up with a set of  
9 goals for section 2, what is the purpose, what are we  
10 trying to do, and then work through various scenarios as  
11 to what the market definition would be under each of  
12 those. So, one potential scenario is, we are going to  
13 say that the goal of section 2 is to prevent unilateral  
14 conduct that is reasonably likely to significantly raise  
15 price or reduce quality. Reasonably significantly, you  
16 can come up with other adjectives, number one.

17 Number two, and you are going to focus on  
18 conduct that either, A, has no efficiencies, B, has  
19 disproportionately low efficiencies relative to their  
20 exclusionary effect, or C, would make no economic sense  
21 in the absence of exclusionary effect, and potentially  
22 D, permits recoupment of the exclusionary conduct. So,  
23 kind of a menu from which to choose.

24 Well, one could argue that the first condition,  
25 that the unilateral conduct be such that it is

1 reasonably likely to significantly raise price and/or  
2 reduce quality, may be a necessary condition. That  
3 defines the universe in which something bad can happen.  
4 If you do not have that condition, then you might be  
5 able to say that nothing bad can really happen. So, you  
6 can use market definition in that sense, to focus on  
7 that aspect as a screen.

8           You then could ask, "Well, gee, would the market  
9 definition need to change depending on your choice of 2A  
10 through D?" And at least at a first cut, I would say  
11 probably not, that these factors relate to what might be  
12 considered defenses or separate prongs of the analysis.  
13 They would not be necessary to worry about in the first  
14 market power screen, where you use market power or  
15 market definition as the screen.

16           All right, so what would be the relevant  
17 context, then, for measuring profitability of a price  
18 increase? Well, obviously the options are before,  
19 during or after the execution of the alleged conduct.  
20 Well, we are concerned with the price going up as a  
21 result of this conduct, so it seems to me you want to  
22 focus on whether there might be a significant price  
23 increase, whether a significant price increase might be  
24 profitable during or after this alleged conduct.

25           Then similarly, if the conduct is already in

1 place, so you cannot observe it over time, then the  
2 question might be the reverse, which is, absent this  
3 conduct, would the price be lower, right?

4           You see, I think there is the same problem here  
5 that you have -- not really a problem, but an issue in  
6 the Merger Guidelines -- where for the most part, you  
7 are measuring the profitability of a price increase  
8 going forward. You are not looking at the current  
9 level. You are really looking at a change in the  
10 current level that is brought about by the conduct that  
11 you are worried about. So, in the merger case, it is  
12 the merger; in this case, it would be the alleged  
13 exclusionary conduct.

14           You know, one of the things that is near and  
15 dear to me, critical loss, might be a tool to help in  
16 this analysis, and it would not be exclusive by any  
17 means. Just like in the Merger Guidelines you can use  
18 critical loss, you can use all kinds of other estimation  
19 techniques, and they are not exclusive.

20           So, one way to think about this would be that  
21 the burden would be on the plaintiff to show the likely  
22 extent to which the alleged conduct restrains  
23 third-party producers; in other words, whatever the  
24 conduct is, exclusive dealing, refusal to deal,  
25 whatever, what is the likely impact on third-party

1 producers? How much restraint does this have on their  
2 ability to supply the market?

3 Then the plaintiff would have to show that it  
4 would be profitable for the monopolist to raise price  
5 significantly -- whatever the number is, 5, 10 percent,  
6 whatever -- as a result of that exclusionary conduct.  
7 You could calculate a critical loss for the monopolist  
8 that would be based on margins, and you could estimate  
9 whether a 10 percent price increase after or during the  
10 alleged conduct would leave sufficient residual supply  
11 such that a monopolist would lose in excess of the  
12 critical loss. So, that would get you the market  
13 definition part of this. Then what do you do?

14 One strategy would be to not even bother with  
15 shares, because you have basically concluded that the  
16 single firm was able to engage in this alleged conduct  
17 and get the price up, and in terms of that, one could  
18 say, "Well, that's what we needed to know," and we will  
19 now we go through the rest of the analysis and determine  
20 what are the efficiencies, and maybe you want to talk  
21 about recoupment as well. So, one could reasonably say,  
22 "Well, we don't really need a market share threshold."  
23 Other people could say, "Well, gee, it is in the case  
24 law. We want to try to make it consistent. It is  
25 really important. So, we need a market share

1 threshold." How would that work?

2 Well, one way to think about it in the context  
3 that I have just outlined would be you could say, "Well,  
4 the firms in the market would be obviously the alleged  
5 predator, and then potentially also other firms that  
6 have also benefitted from a price increase as a result  
7 of this exclusionary conduct," and you might base their  
8 share calculations on their sales of that product for  
9 which the price increase was experienced.

10 But then you ask the question, "Well, why have a  
11 share requirement? What does that do for you?" You  
12 might say, "Well, it gives us some comfort because  
13 predatory conduct is only likely to occur where the  
14 shares are high." Well, there is an issue about that,  
15 because some exclusionary conduct is really cheap, and  
16 some exclusionary conduct is really expensive. So, if  
17 you are going to engage in really expensive exclusionary  
18 conduct, yes, then you probably want to have a big  
19 share, because you need to recover that expense that you  
20 laid out to execute the exclusionary conduct, but if you  
21 are executing really cheap exclusion involving, a  
22 Hatch-Waxman type of scenario or something like that,  
23 which costs virtually nothing, well, then, what does the  
24 market share do for you? So, that is unclear.

25 I have got about 30 seconds left, and I just

1 wanted to sum up by saying I think there are some really  
2 important lessons to be learned from the Horizontal  
3 Merger Guidelines market definition, and I am hopeful  
4 that what will come out of this is we will get a bunch  
5 of smart people in a room, maybe Greg and some of his  
6 colleagues from the Antitrust Division and the FTC will  
7 sit in a room, take all of this together, and come out  
8 with an algorithm that is of similar significance to  
9 what they did with the Merger Guidelines -- use the  
10 first principles integrated approach, not worry about  
11 the fact that what they might come out with is a  
12 theoretic framework, theoretic algorithm that is not  
13 immediately implementable, and then not be afraid to  
14 consider a market definition guideline that deviates  
15 from traditional case law, because what happened with  
16 the Merger Guidelines is people originally said, "Oh,  
17 this is nothing like the original case law," and now we  
18 have been able to bring the two together, and the courts  
19 have seemed to have adopted what is in the Guidelines.

20 Thanks very much.

21 (Applause.)

22 DR. CARLTON: Thank you, Joe.

23 Our next speaker is Larry White, who has arrived  
24 in time. You have already been introduced, Larry.

25 DR. WHITE: Well, thank you.

1 DR. CARLTON: And the ground rules are we are  
2 running a little late, so if you could keep to 15  
3 minutes.

4 DR. WHITE: Right.

5 DR. CARLTON: Does the computer work?

6 UNIDENTIFIED SPEAKER: Yes.

7 DR. CARLTON: And you are the first person who  
8 has the use of the computer.

9 DR. WHITE: All right, great. Well, thank you.  
10 I am very pleased to be here this morning, and sorry for  
11 the delay of my arrival. I flew down from New York this  
12 morning, and every once in a while you get hit with a --  
13 I do not know whether it is the right-hand tale or  
14 left-hand tale on variance, but we were an hour late  
15 taking off. So, here I am. I am very pleased to be  
16 here.

17 I think this is a terrifically important issue,  
18 and it is an issue where unfortunately too many mistakes  
19 have been made, too many mistakes continue to be made,  
20 and I want to walk you through what I consider to be  
21 some important issues. I have got a few call it partial  
22 answers. I do not have the complete answer. At the  
23 end, I am going to be echoing Joe Simons' call. We need  
24 a new paradigm; a paradigm is missing.

25 So, like any good business school professor, I

1 am going to tell you what I am going to say, and then I  
2 am going to say it, and then I am going to tell you what  
3 I said. I will frame the issue, I will remind you what  
4 the standard monopoly model looks like, I will remind  
5 you what the implications of that model are, I will  
6 point out the loose language that has been used by  
7 people who do know better or who ought to know better,  
8 and I'll tell you about the danger of that loose  
9 language. That will bring me to the Cellophane fallacy.  
10 Everybody is going to talk -- you cannot not talk about  
11 the Cellophane fallacy when we're addressing this topic,  
12 remind you of an ongoing dilemma, put out some partial  
13 suggestions, and wrap it up.

14 What's the issue? I am not going to get into  
15 this market power versus monopoly power. The way I was  
16 taught, it is all the same thing, and the exercise of  
17 this thing, call it monopoly power or market power, is  
18 the seller can sell at prices above marginal cost and  
19 earn rents, and I should have added for a sustained  
20 period of time, but I will go ahead with my story. That  
21 is the picture that we carry around in our head of what  
22 monopoly power, market power, is about, the sustained  
23 charging of a price above marginal cost, maintaining --  
24 I am going to use that word over and over again --  
25 maintaining a price substantially above marginal cost.



1 All right, now, what also gets talked about,  
2 especially in an antitrust context, is actions --  
3 exclusionary, predatory actions -- that can create or  
4 enhance market power. So, somebody who did not have it,  
5 can create it. Somebody who has it through an  
6 exclusionary or predatory action can enhance it, make  
7 the demand curve yet less elastic or inelastic and earn  
8 even higher rents.

9 If the seller is engaging in this kind of  
10 activity, whether he is exercising the market power or  
11 enhancing, a likely precondition is that the seller has  
12 a large share of its market. So, that is not necessary.  
13 You can come up with examples where if the overall  
14 supply is limited, where other suppliers cannot expand  
15 their output very much, where demand is quite inelastic,  
16 even somebody with a relatively small share of a  
17 commodity market by his unilateral actions can affect  
18 the price, but more generally, a large share of  
19 something called a market is going to be necessary. But  
20 that then raises this threshold or safe harbor issue,  
21 what is the market, and there is no standard paradigm  
22 for that determination.

23 So, this is the picture we carry around in our  
24 head, and the implications of that picture, the  
25 monopolist maintains its price at a level above the

1 competitive price. He would not want to raise his price  
2 any further unless demand changed or costs changed. He  
3 is already where he wants to be. In trying to raise his  
4 price, he would lose too many customers to sellers of  
5 something else, and, of course, if the market changes  
6 from a competitive structure to a monopoly -- because of  
7 cartelization, because of exclusion -- then the price  
8 changes, then the price increases, the seller, newly  
9 feeling this market power, raises the price from the  
10 competitive to the noncompetitive monopoly level, but as  
11 a characterization of what is going on when we take a  
12 snapshot of the market, he is maintaining the price at a  
13 level above the competitive level. That is clear in  
14 this standard model.

15 About 40 years ago, George Stigler developed an  
16 expanded version of this, the dominant firm and the  
17 inverted price umbrella, where he described a firm that  
18 was not strictly a monopolist, he faced a reactive  
19 fringe of smaller firms that were limited in their  
20 supply response, and he showed basically you get a  
21 similar type of outcome. The dominant firm is able to  
22 charge, maintain a price above competitive levels, but  
23 he doesn't want to go any higher because -- and there,  
24 in the Stigler model, it is implicit -- he would lose  
25 too many sales to that competitive fringe.

1           Okay, why am I making such a big deal out of  
2 this? Because there has been loose language out there,  
3 first by my colleagues, all of whom do know better, and  
4 they describe the phenomenon of monopoly power, market  
5 power, in terms of the ability of the firm to raise  
6 prices. In other words, I have put in italics over and  
7 over again, this language of "raise prices," or in the  
8 context of the Microsoft case, Fisher and Rubinfeld  
9 making this claim that, "Gee, Microsoft could have  
10 raised its price substantially and wouldn't have lost  
11 customers," and you have got to scratch your head, how  
12 come they didn't? Then Evans and Schmalensee on the  
13 other side, again, talking the language of "raise."

14           Even earlier, as I walked in the door, I heard  
15 Phil Nelson talking about the monopolist "raising" the  
16 price. Maintaining is what we're talking about, but I  
17 am sure I in my looser moments fall into this "raising."  
18 It is an easy thing to do, but I am going to show you  
19 the dangers of it in just a minute.

20           I'll go over to some noted legal cases and legal  
21 opinions, and again, you have got the same -- oh, did  
22 I -- no, I forgot to put the italics in there, but you  
23 can see the word "raise" in each of those -- in each of  
24 those quotations from those cases.

25           All right, what is the danger? The danger in

1 the "raise" terminology is that if we think market power  
2 and monopoly power are the ability to raise the price,  
3 then it is easy to then think, "Ah, well, the test of  
4 whether somebody has market power or not is whether the  
5 seller can raise prices above currently observed  
6 levels." Remember, that is what Fisher and Rubinfeld  
7 were talking about there.

8           Conversely, if the seller is constrained from  
9 raising prices because of its fears of losing too many  
10 customers, then does that imply that it does not have  
11 market power? The trouble is, even in the standard  
12 paradigm where the monopolist is maintaining a price  
13 above competitive levels, it cannot profitably raise its  
14 price because it would lose too many customers to  
15 sellers of something else.

16           That, of course, then leads us to the Cellophane  
17 fallacy, the U.S. v. Dupont case, where the issue was,  
18 was the market a narrow market of cellophane, in which  
19 case it is clear, Dupont had market power. There was  
20 one other seller of cellophane, Sylvania. It was under  
21 license from Dupont, and so, effectively, no question.  
22 If the market was cellophane, Dupont had market power.  
23 Or was it, as Dupont claimed, flexible wrapping  
24 materials, in which case Dupont only had a 17.9 percent  
25 share and didn't have market power?

1           The Supreme Court majority said it was  
2 interchangeability that carried the day, that cellophane  
3 was interchangeable with other materials mentioned --  
4 there was wax paper and brown wrapping paper and  
5 aluminum foil and glassine and lots of other things --  
6 and the majority said, "Ah, look, it is interchangeable.  
7 Dupont can't raise its price. So, it must be part of  
8 that larger market."

9           The minority pointed out the fallacy of that  
10 reasoning and also pointed out the comparison with  
11 rayon, where Dupont also faced 15 to 18 other producers,  
12 also had a market share that was below 20 percent, and  
13 made much less profits. They also pointed out that  
14 Dupont's price of cellophane did not move around when  
15 those other flexible materials' prices changed.

16           So, we have this ongoing dilemma. Profit data  
17 nowadays are relied on a whole lot less than was the  
18 case back in the fifties when Stocking and Mueller were  
19 writing, when the Supreme Court minority relied on those  
20 profit data. The Horizontal Merger Guidelines cannot be  
21 used, because they are a forward look, as you have heard  
22 already, they are a forward-looking test.

23           The one exception, which Greg Werden has pointed  
24 out, is that if we are talking about a practice that is  
25 not yet in place, say an exclusive dealing plan that is

1 going to be put in place. A plaintiff comes in, asks  
2 for an injunction. We are talking about something where  
3 it is a prospective practice. Then the prospective,  
4 forward-looking paradigm of the Merger Guidelines will  
5 work. To the extent that that is what we are looking  
6 at, fine, we have got an answer, but lots of instances  
7 are not of that kind.

8 As Phil remarked earlier, elasticities do not  
9 help us very much. You cannot tell the difference  
10 between a true monopolist and just a different -- a  
11 seller of a differentiated product, a Chamberlin/  
12 Robinson monopolistic competitor.

13 Okay, what to do? Well, sometimes a complaint  
14 will involve a prospective practice, and then we have  
15 got the Merger Guidelines. Sometimes there will be  
16 cross-sectional or time-series evidence involving prices  
17 where we can tell that concentration matters, and when  
18 concentration matters, you have got a market, and retail  
19 services are an area where cross-sectional data may be  
20 available.

21 I harken back now ten years to the Staples case,  
22 where cross-section data showed that prices were  
23 different, higher where only Staples or Office Depot was  
24 present in the market, lower when both were there, yet  
25 lower when they and a third office superstore were

1       there. That evidence carried the day, and I think  
2       correctly, that there was a problem -- there would be a  
3       problem if the two firms merged, and it told us office  
4       superstores were a market.

5               Think of the American Airlines predatory  
6       behavior case. Why do we think that city pairs are a  
7       market, city pairs airline transportation? Because  
8       there is lots of cross-sectional evidence that shows  
9       that, controlling for other things, prices matter and  
10      prices are related to concentration. Sometimes profit  
11      data will be useful.

12             I mean, if you think the Microsoft case was a  
13      good case, if you thought that Microsoft's behavior was  
14      a problem, why did you think that? And I think at least  
15      part of the story was those profits. They were so large  
16      that even with all the problems that we know about  
17      profits, they were telling us something. But what if  
18      none of these possibilities are available?

19             Well, Phil Nelson and I a few years ago made a  
20      proposal. It turns out similar language can be found in  
21      a 20-year-old article by Tom Krattenmaker. Greg had a  
22      version of this proposal in an article he wrote in 2000,  
23      where basically it is asking in the presence of an  
24      allegation of exclusion, what would have been the  
25      consequences of the absence of exclusion? It requires a

1 two-step investigation.

2 First you have got to ask, in the absence of  
3 exclusion, what would the plaintiff's sales have been?  
4 And then you have got to ask, what would the price  
5 consequences of those additional sales have been as  
6 well?

7 Now, as was indicated earlier, this would focus  
8 directly on effect, and it implicitly delineates a  
9 market, but if you think about what the unilateral  
10 effects analysis under the Horizontal Merger Guidelines  
11 does, it is basically doing the same thing. It is  
12 looking for an effect, and then, if somebody goes ahead  
13 and then tries to delineate a market, that is sort of  
14 redundant. You have already found the effect.  
15 Implicitly, you have said there must be a market there,  
16 and that is basically what the Nelson and White proposal  
17 does as well.

18 But I think the best approach would be let's try  
19 to develop -- you know, I have thought hard about it.  
20 The best I could come up with was this joint proposal  
21 with Phil. It may not be good enough. Can the world  
22 come up -- can the Division, can the FTC, can a bunch of  
23 smart people out there -- come up with a paradigm that  
24 will have the power and eventual universality of the  
25 Horizontal Merger Guidelines?



1           I urge you, remember what the world looked like  
2 before 1982. Remember what 1981, 1980 and 1979 looked  
3 like. We did not have a paradigm. We had  
4 Elzinga-Hogarty. We had Ira Horowitz's suggestion.  
5 There were other ideas out there. George Hay was going  
6 around talking about how the Division defined markets,  
7 and he would say, "Well, we would look for whether there  
8 was a specialized trade journal that the sellers in a  
9 marketplace all submitted their data to." Those were  
10 the kinds of indicia that people looked to. The Merger  
11 Guidelines brushed all that stuff away, and we have now  
12 got a powerful paradigm. I hope that some smart people  
13 out there somewhere will be able to develop something  
14 with similar power.

15           So, winding up, we have got an unsatisfactory  
16 state for market definition. I would hope we are in  
17 1981, and next year, somebody is going to come up with  
18 something that will have the same kind of power as the  
19 Horizontal Merger Guidelines. I have shown you some  
20 partial remedies, but the best remedy would be a new  
21 paradigm.

22           Thank you very much. I am very pleased to have  
23 this opportunity today.

24           (Applause.)

25           DR. CARLTON: Okay, thank you, Larry.

1           Our next speaker is Andy Gavil.

2           DR. GAVIL: Good morning, everyone. Thank you  
3 to the organizers for inviting me to join everyone  
4 today. I am delighted to be here and agree with  
5 everyone else that these are some very important --  
6 indeed, fundamental -- issues to how we go about  
7 analyzing antitrust cases, and in truth, they are not at  
8 all unique to section 2. Questions of power and effects  
9 really cut across all kinds of cases today. So,  
10 resolving one area clearly is going to influence and  
11 affect the others just as the Merger Guidelines has  
12 affected many areas.

13           So, I start with my first slide in talking about  
14 it is all about anticompetitive effects, and I think I  
15 would add to that, and legal process. At the end of the  
16 day -- that is a great phrase, "At the end of the  
17 day" -- "At the end of the day, in the final  
18 analysis" -- but at the end of the day, in the final  
19 analysis, whatever we conclude as a matter of economics  
20 is the right approach, we have to translate that into a  
21 legal system of decision-making. It has to work in  
22 courts. It has to work in a context where we have  
23 burdens of pleading and burdens of production and  
24 burdens of proof. It has to work in a context where we  
25 have various methods for discovery of evidence, where we

1 have a role for expert witnesses, where we have judges  
2 and juries, and if it cannot work in that context, then  
3 perhaps there is a problem with what we have come up  
4 with as a theoretical matter.

5 I forget who it was, I think it was Joe talking  
6 earlier about how the Merger Guidelines were originally  
7 received. Well, part of the problem in how they were  
8 received is that they were received by a legal community  
9 accustomed to looking at cases in one particular way.  
10 They suggested that we needed to look at those cases in  
11 a very different way, and it was very unclear in 1982  
12 how you would translate, how you would take something  
13 like SSNIP and what evidence would you need?

14 The lawyers that were asking the questions of,  
15 what witness am I going to need to do this? What  
16 evidence will I need from my client, from the other  
17 parties? How will I assemble it? How will I present  
18 it? There can be no doubt at all I think in anybody's  
19 mind that the Merger Guidelines and subsequent  
20 developments have been an economist's full employment  
21 act, and certainly that has been evidenced in the  
22 antitrust area. It is hard to imagine today proving any  
23 kind of case, plaintiff or defense, without the role of  
24 economists, and that is a result of the writing into our  
25 substantive standards various economic ideas.

1           So, as I go through these slides, I want you to  
2 sort of keep that in mind. The focus I have tried to  
3 bring to my comments today is, how do we make it work in  
4 this legal system? Well, common issues in antitrust are  
5 effects, and we have certain ways that we go about  
6 establishing them. We have irrebuttable presumptions --  
7 that is what the per se rule is all about -- and we have  
8 rebuttable presumptions; whether we are using direct  
9 evidence or circumstantial evidence -- and that is going  
10 to be an important issue that I am going to look at  
11 today -- we have different ways that we go about trying  
12 to establish effects.

13           Direct evidence, defined here, is the actual  
14 exercise of market power. It may come out in  
15 performance evidence. It may come out in before and  
16 after studies of price. It is reflected to some degree  
17 in our use of "quick look." The "inherently suspect"  
18 formulation is also a way of looking at things that are  
19 obvious, and a question I will be asking today is, do we  
20 have equivalents for section 2 and would it make sense  
21 to use them in section 2?

22           On the circumstantial evidence side, we have  
23 something that I have called a "double inference." We  
24 define a market, we calculate market shares from a  
25 certain level of market share, we infer market power,

1 and in truth, from that, we then infer the capacity for  
2 anticompetitive effect. In litigating terms, we are  
3 dealing with two very standard paradigms of how to go  
4 about proving something.

5 Well, power, of course, is a condition precedent  
6 of effects, but if you look in the cases, there is a lot  
7 of confusion -- again, loose language -- about how it is  
8 used. Some cases say, "Well, what we need is market  
9 power," and even in cases like NCAA and Indiana  
10 Federation of Dentists that really were out in the  
11 forefront in this quick look idea and the use of direct  
12 evidence of actual effects, there is confusing language  
13 about what "market power" means.

14 Well, power is the condition precedent of  
15 effects. If you have the effects, the power is there.  
16 So, part of the point of Indiana Federation, talking  
17 about market definition and market power as surrogates,  
18 was to make the point that when you have the actual  
19 effects evidence, going sort of back around the  
20 circumstantial evidence route, trying to define a market  
21 and determine whether there are large market shares, may  
22 be beside the point. Those things are surrogates for  
23 direct evidence.

24 Well, as in many areas of antitrust, that leads  
25 us to a point where we can identify easy cases and hard

1 cases. A good example I think of the easy cases, when  
2 the direct and circumstantial evidence are aligned, when  
3 they are pointing in the same direction, when you have  
4 evidence of actual effects and you have high market  
5 shares, those are easy cases. We do not argue about  
6 those very much. The D.C. Circuit in Microsoft actually  
7 structured its discussion of monopoly power that way,  
8 looking at both direct evidence, circumstantial  
9 evidence, they are both pointing in the same direction,  
10 easy case.

11 On the other hand, for safe harbor ideas, if you  
12 have de minimus evidence and no effects and you have low  
13 market shares, again, pointing in the same direction,  
14 and I would make this point -- I'll raise it a little  
15 bit later -- in terms of safe harbors, I do not think  
16 you can rely just on market shares alone. It has to be  
17 market shares plus certain other factors, and I will  
18 also suggest that if we are going to have safe harbors,  
19 we need some danger zones, and again, it might be market  
20 share plus some other characteristics.

21 But evidence and power effects are interrelated,  
22 and I think this is what makes part of our current  
23 framework very difficult to think about. Courts do  
24 think, because of years and years of case law, first  
25 monopoly power, then willful acquisition or maintenance,

1 when in truth, the evidence of conduct and effects in  
2 the evidence of power is going to be very interrelated.

3 Well, again, thinking about direct and  
4 circumstantial evidence, the benchmark for  
5 circumstantial evidence is clearly the Horizontal Merger  
6 Guidelines. They really did advance the science of  
7 thinking in terms of circumstantial evidence. Recall,  
8 though, that Cellophane was a section 2 case, and maybe  
9 there are some different problems that come up when we  
10 are doing prospective predictions about likely market  
11 power versus retrospective methods when we have, you  
12 know, the before and after ability to actually look at  
13 the effect of conducts, but the Merger Guidelines in any  
14 paradigm we come up with are probably going to have some  
15 continuing significance. They have been cited by courts  
16 outside of section 7. They are cited in section 1 cases  
17 and section 2 cases. Basic ideas and concepts are  
18 clearly interrelated.

19 So, my suggestion at this stage of our  
20 development is we need something of a similar to the  
21 Merger Guidelines to refine "actual exercise" standards  
22 and to harmonize those standards across different  
23 offenses. A critical question, I think, is how much and  
24 what kinds of effects evidence should be sufficient to  
25 shift a burden? And here I remind, again, that outside

1 the area of exercising prosecutorial discretion, outside  
2 the walls of the agencies when they are deciding whether  
3 to bring a case, if the decision to bring a case is made  
4 and the economists agree, the next question the lawyers  
5 are going to have is, "Well, how do we meet our burden  
6 of production? What evidence are we going to assemble?  
7 What is going to make us win this case?"

8 I think when you are thinking about direct  
9 effects evidence, and market share as well, a critical  
10 question in section 2 is, what does it take to shift a  
11 burden? Frequently what you see defendants arguing in  
12 cases is the burden didn't shift, the burden didn't  
13 shift, the burden didn't shift. Well, what does that  
14 mean?

15 It means that there is no requirement on the  
16 part of the defendants to actually justify their  
17 conduct. If they claim there are efficiencies, where is  
18 the evidence of efficiencies? That does not happen  
19 until the burden shift takes place. That is a critical  
20 stage. It is a critical stage that has to be focused  
21 on, and I have given some examples here of various cases  
22 that raise some of those questions.

23 I think we are also feeling the weight of the  
24 Alcoa paradigm. In looking back at Alcoa and the cases  
25 that preceded it, all Judge Hand did was he surveyed the



1 previous cases and looked at winners and losers to come  
2 up with his three famous sort of -- you know, 33, not  
3 enough; 66, maybe; over 90, definitely. Well, where did  
4 he get that from?

5           If you look at the prior Supreme Court cases,  
6 you will see that there were cases falling into each of  
7 those categories. He sort of synthesized them and came  
8 up with this benchmark. I think an important question  
9 for us is, are we ready to move beyond the total  
10 reliance on market shares, which sends us off in this  
11 direction of conflicting evidence, plaintiffs and  
12 defendants having experts -- the market is big, the  
13 market is small -- and is that really where we want to  
14 be? What can the role of direct evidence be?

15           The Re/Max case was an example of a court  
16 relying on direct evidence, actual price effects  
17 evidence in a section 2 case. The 7th Circuit in  
18 Republic Tobacco rejected such an approach, said that  
19 Indiana Federation did not apply and NCAA did not apply  
20 to a vertical case. Is Staples -- and the unilateral  
21 effects that people have alluded to already -- is it  
22 related? I think it is. It is a way of trying to more  
23 directly gauge. We have talked about the monopoly  
24 versus market power being kind of a silly distinction.  
25 So, I will move on.

1           I think there is an important role here for  
2 decision theory, which obviously has begun to influence  
3 our thinking. The emphasis tends to be on fear of error  
4 costs, and often that motivates calls for more and  
5 better evidence. We need more before that burden  
6 shifts. One point I would like to walk away with today  
7 is urging that we also consider the second half of  
8 decision theory, which is process and information costs.  
9 Is more evidence really always better?

10           In that regard, I sort of suggest -- and it is  
11 not really new, there is a lot of general literature out  
12 there on the economics of evidence. Richard Posner has  
13 a long article on an economic analysis of evidence, and  
14 I put forward the question, "When does the marginal  
15 value of additional evidence in terms of economic  
16 certainty (minimizing error costs) outweigh the costs of  
17 obtaining and processing that evidence, taking into  
18 account whether it is reasonably accessible to the party  
19 bearing the risk of non-persuasion?" What I tried to do  
20 in that question is integrate some economic ideas and  
21 some legal process ideas from both the rules of  
22 procedure and the rules of evidence. It is always easy  
23 to demand more. It is always easy to pursue some kind  
24 of level of absolute certainty and minimal error costs.  
25 The question is, as a legal standard, when we take that

1     into court, is that really going to strike the right  
2     balance for us in resolving cases?

3             Antitrust is not always rocket science, and I  
4     think we need to get over the idea that it always is.  
5     Yes, we need safe harbors to guard against false  
6     positives. I think we also should be emphasizing  
7     equally defining danger zones where we might be running  
8     into false negatives.

9             Is monopoly power all that puzzling? I would  
10    point out to everyone that neither 3M nor U.S. Tobacco,  
11    in two U.S. Courts of Appeals monopolization cases, even  
12    contested that they had monopoly power. In the  
13    Microsoft case, they contested it, but rather  
14    unpersuasively, and every agency and every court to look  
15    at it has concluded that yes, indeed, Microsoft had  
16    monopoly power.

17            We could go on with a couple other examples,  
18    American Airlines, Dentsply. Were these really such  
19    difficult cases? If they were not, then why were they  
20    so difficult? Why would parties not even litigate the  
21    point about their power? There must be, there must be  
22    cases where -- again, market share plus -- where there  
23    must be additional factors, information on entry  
24    barriers. Entry barriers will always, for example, be  
25    important.

1           Finally on this slide, sliding scales, not all  
2 burden shifts are created equally. You see this in  
3 cases like Baker Hughes and Heinz in the merger area,  
4 the realization that sometimes when a burden shifts, it  
5 really shifts, and the presumption is very strong, and  
6 other times, it kind of is just enough to shift. Well,  
7 in responding to those sorts of cases, we might want to  
8 respond in different ways by considering what is  
9 required to shift and what is required to shift back a  
10 burden in different ways.

11           On legal standards and decision-making, I think  
12 that the balancing of effects idea is a straw man. We  
13 could cite, as Larry White did, we could put up lots of  
14 slides with courts saying, "Anticompetitive effects; the  
15 burden shifts. Efficiencies; then we balance one  
16 against the other." We do not really do that. I have  
17 looked; you can all look. If you can find me a Section  
18 1 litigated case in which the case was actually decided  
19 on balancing effects versus efficiency effects, consumer  
20 surplus diminution versus increased producer surplus,  
21 find me such a case. I would like to see it. It is not  
22 what we do.

23           What we do is weigh evidence. What juries do is  
24 they compare the evidence of anticompetitive effects  
25 with the evidence of efficiencies, and they make a

1 decision about where the weight of the evidence is.  
2 That has to do with credibility; it has to do with  
3 persuasiveness. It does not have to do with \$10 of  
4 anticompetitive effect and \$11 of efficiency.

5 Finally, a word about caricatures and corrosion  
6 of the rule of law. The level of discourse and the  
7 level of criticism of antitrust, as we all know, has  
8 continued for quite some time. It has continued despite  
9 the fact that in the last 40 years, we have seen some  
10 pretty major corrections to antitrust.

11 I say caricature -- and this is not my  
12 caricature -- but this is what you see in a lot of the  
13 criticisms of antitrust, and I think it is a caricature  
14 that ignores this last period of adjustment over the  
15 last 30 years. Incompetence -- judges, just  
16 incompetent. They can do habeus corpus, they can do  
17 environmental, they can do securities law, but antitrust  
18 is rocket science, keep them away.

19 The same thing with juries. They just do not  
20 know the difference between somebody who is full of it  
21 and somebody who really knows what they are doing. They  
22 cannot tell the difference between economists in this  
23 case and, of course, neither can they decide any other  
24 possible case.

25 And, of course, enforcers. I have the asterisk

1 there just to remind me to say that. Typically it is  
2 enforcers themselves who make this argument, God, we are  
3 so stupid. You shouldn't really trust us to make any  
4 decisions, and although we may -- and it gets very  
5 personal -- we may be able to make the decision, but  
6 other enforcers are really stupid, especially those guys  
7 at the offices of the states.

8 Who are the untrustworthy self-interesteds, the  
9 self-interesteds who are untrustworthy? Rivals, oh,  
10 they are always full of it. They are always complaining  
11 about more competition. Dealers, yeah, what's that  
12 freedom of dealer stuff? You know, manufacturers,  
13 consumers, aligned; dealers, out in left field. And  
14 plaintiffs pretty much all are full of it, especially  
15 class action reps.

16 Ah, but who can we trust? Dominant firms.  
17 Dominant firms articulating efficiencies. Fear of error  
18 cost? That's truth. We need to put a lot of weight in  
19 that. We need to be concerned about it. Other  
20 defendants, generally yeah, and especially efficiencies.

21 Two problems I have with this sort of  
22 caricaturing of antitrust. One is, I don't think it is  
23 true. I would like to see the list of false positives  
24 in the last 25 years. We have been moving towards  
25 reduced error costs, and here I think it would be

1 helpful to have the economists really define what they  
2 mean as "false positive." It is not a case on which  
3 reasonable people can differ. It is a case that sort  
4 of -- again, borrowing from procedure -- no reasonable  
5 party could have come out that way. To me, that would  
6 be a false positive or a false negative. It is not a  
7 case that we simply disagree about.

8 LePage's has, you know, been frequently used as  
9 sort of this example of a false positive. Be reminded  
10 that 3M did not contest its market power, and if it did  
11 offer any evidence of efficiencies, nobody who looked at  
12 it found it very convincing. Did the Court of Appeals  
13 give us a useful standard for bundled pricing? No, but  
14 neither has anybody else yet. So, to call that a false  
15 positive and say, "This is an example of how we're going  
16 to inhibit all kinds of other cases," I am not sure that  
17 that is justified.

18 The final point and I will sit down. As I said  
19 at the start, Larry said at the end, you say what you  
20 said at the beginning. At the end of the day, these  
21 cases have to go to court sometimes, and this kind of  
22 rhetoric of criticism ultimately is corrosive of the  
23 rule of law. I think it is heard in curious ways  
24 outside the United States. These criticisms really go  
25 to the heart of whether we are willing, at the end of

1 the day, to rely on courts to make decisions.

2 We have numerous procedural devices, summary  
3 judgment, judgment as a matter of law, Daubert  
4 standards, appeal rights. If after all of that has  
5 occurred a plaintiff actually wins a case, which does  
6 not happen very often, I think we ought to be a little  
7 bit more cautious about tossing the rhetoric around  
8 about the incompetence and the untrustworthy  
9 self-interesteds, all right?

10 Thanks very much.

11 (Applause.)

12 DR. CARLTON: Thank you very much, Andy. I was  
13 pleased to hear I am not as incompetent as once  
14 enforcers were thought to be, and to prove that I am  
15 still competent, we are going to have a break, and it  
16 will be a 10-minute break, and we will reconvene  
17 promptly so that we can try and stay roughly on  
18 schedule. Thank you.

19 (A brief recess was taken.)

20 DR. CARLTON: Why don't we try and start. Our  
21 next speaker is Rich Gilbert.

22 DR. GILBERT: I would like to thank the  
23 organizers for the opportunity to be here. I was  
24 invited to talk about technology markets, so if any ink  
25 gets spilled on this issue as a result of my comments,



1 you can be sure it will be Independent Ink, though I  
2 will not talk about the presumption of market power for  
3 patents. I thought we resolved that issue in the IP  
4 Guidelines, although it is not the case that the Supreme  
5 Court immediately adopts everything that the agencies  
6 come up with.

7 Now, when we talk about market definition, there  
8 is a real sense in which we are talking about either  
9 guide posts or lamp posts. Now, lamp posts, as you  
10 know, shed light on a subject but do not necessarily  
11 shed truth about the subject. A lamp post might  
12 illuminate the ground, but that does not mean that the  
13 dollar that we are looking for is around the lamp post,  
14 even though if it were, perhaps we could see it.

15 Guide posts, on the other hand, serve to focus  
16 the analysis. The guide posts lead the way. The way  
17 may be very foggy and very complicated and very  
18 difficult, but can be very useful.

19 Now, my take, sort of in the spirit of Andy's  
20 comments, the courts and defendants like the market  
21 definition exercise, even though it is often used much  
22 more as a lamp post than a guide post. They like the  
23 exercise because, of course, for a defendant, if you can  
24 show the market is very broad, chances are there is no  
25 antitrust case there. For a court, they are all very

1 busy. They have full dockets. If you can show the  
2 market is very broad, they do not have to worry about  
3 it.

4 Plaintiffs also seem to like market definition  
5 or many of them like market definition, because if you  
6 can prove that or demonstrate or make a convincing case  
7 that the market is narrow, well, chances are then there  
8 will be an issue, but as I think everybody on this panel  
9 is implying, none of those conditions, whether it is  
10 broad or narrow, presumptive of a case or not  
11 presumptive of a case, none of them are really relevant  
12 directly to the analysis. We would rather have market  
13 definition serve as the guide post to lead the way to  
14 the right analysis rather than defining whether there is  
15 or is not a case.

16 Now, so, if we talk about markets for  
17 technology -- first I should distinguish, I am going to  
18 focus more on technology markets than on markets for  
19 technology. Markets for technology can be analyzed  
20 using conventional goods markets, often using  
21 conventional goods markets, which are sufficient for  
22 analysis in many high technology industries, whereas  
23 technology markets are useful when what is at issue is a  
24 right or rights to a technology that are licensed rather  
25 than embodied in a patent. So, I am focusing more on

1 technology markets than markets for technology, although  
2 maybe in discussion, we will get to that distinction,  
3 whether there should be a distinction.

4 Technology markets are defined in the IP  
5 Guidelines. Technology markets consist of the  
6 intellectual property that is licensed that are close  
7 substitutes. Of course, here now, as in all market  
8 definition exercises, the issue is, what are the close  
9 substitutes? And when you are talking about technology  
10 markets, the close substitutes are not only other  
11 intellectual property rights, but also goods and  
12 services that may substitute for those intellectual  
13 property rights.

14 It adds another layer of difficulty and  
15 complexity to the analysis, because just like in  
16 conventional -- other section 2 goods market definition,  
17 exactly what to sweep into that analysis and how, it  
18 depends upon the prices, prevailing prices, and whether  
19 the conduct is prospective or retrospective, these are  
20 all challenging issues, which I am not going to entirely  
21 resolve.

22 Now, technology markets also are -- there is an  
23 upstream analysis for inputs which I think raises some  
24 interesting questions by itself. Technology markets  
25 have been used I think with some success to analyze the

1     licensing of technology to manufacture float glass, for  
2     blending clean gasoline in the UNOCAL case, the float  
3     glass with the Pilkington case, for designing fast  
4     computer memory chips, as in the DRAM cases, perform  
5     laser eye surgery, or to incorporate genetically  
6     modified traits into agricultural seeds. These are all  
7     some examples, I think, of markets that have been  
8     analyzed using basically an upstream analysis for  
9     licensed inputs.

10           Now, on the geographic market side, this is an  
11     area where using technology markets in some cases  
12     simplifies things. It is fair, I believe, to presume in  
13     many cases -- not all, of course -- the geographic scope  
14     for technology markets is very wide, because it is not  
15     very difficult for a potential licensee to negotiate  
16     with even quite distant licensors unless there are legal  
17     or regulatory or some other restrictions that prevent  
18     the use of licensed technology in different locations,  
19     as there was, for example, with the UNOCAL case, but in  
20     these other cases, the enforcement agencies I think have  
21     correctly concluded that the technology markets are very  
22     broad, U.S.-wide and sometimes worldwide.

23           Now, technology fees, should these be indicators  
24     of market power? Interesting question which has not  
25     been quite directly addressed. Marginal cost of

1 licensing is typically very low. It suggests that there  
2 is market power if we define market power as the ability  
3 to sustain prices above marginal cost, then looking at  
4 technology fees, gives you an immediate read on whether  
5 or not there is market power, not necessarily monopoly  
6 power, but, as economists have said, that is a difficult  
7 line to draw between market power and monopoly power.

8           Now, again, the relevant question is the ability  
9 to increase or maintain technology fees significantly  
10 above marginal cost for an extended time. In this  
11 dispute about market power versus monopoly power, I am  
12 certainly in the camp that says that monopoly power is a  
13 lot of market power and that there is no clear dividing  
14 line between the two, and the question is, the relevant  
15 question is, is there conduct that leads to either  
16 increasing or maintaining technology fees significantly  
17 above marginal cost for an extended period of time and  
18 whether it is prospective or retrospective?

19           If it is prospective, perhaps the ability is to  
20 increase technology fees. If it is retrospective, then  
21 the question is more has conduct contributed to the  
22 ability to maintain technology fees significantly above  
23 marginal cost?

24           This is now more in the spirit of what Larry  
25 White was saying in his approach to section 2 market

1 definition. Also for technology fees, a related and  
2 relevant question in a section 2 context is whether  
3 competition, whether injecting more competition, would  
4 result in a significantly lower technology fee if the  
5 competition were not excluded.

6 I also agree that this opens up a lot of  
7 interesting and unresolved issues, as in how much  
8 competition should be enough to consider? What should  
9 the price effect of that competition be in order to  
10 define a relevant market? Is an elasticity of demand  
11 faced at the existing prices for the fees and other  
12 goods and services? Is an elasticity of demand minus  
13 two, is that low enough, small enough in magnitude, or  
14 does it have to be minus 1.1 or 1.5 or is minus 3  
15 enough?

16 These are very important and serious questions  
17 that need to be addressed if we are going to do this  
18 kind of hypothetical decrease in price through a  
19 hypothetical increase in output as a way to identify a  
20 relevant market.

21 So, the focus on that additional competition and  
22 whether it lowers the fee I do believe can get around  
23 the Cellophane fallacy, and I think another important  
24 aspect of that approach is that it focuses the analysis,  
25 the definition of the market, on the analysis of the

1 competitive effects of the conduct. So, I think  
2 sometimes it is a criticism of the hypothetical decrease  
3 in price approach that it is too related to the conduct  
4 that is being alleged as anticompetitive.

5 I turn it around and say that no, I think it is  
6 an advantage of this approach, because it connects the  
7 conduct at issue to the analysis of the impacts at  
8 issue. Too often, I think many of us would agree that  
9 the market definition exercise puts the cart in front of  
10 the horse. We should be thinking about where are the  
11 competitive effects, how significant can the competitive  
12 effects be, and then let the market definition respond  
13 to that rather than defining where the competitive  
14 effects are. Again, this stems from the problem of the  
15 Cellophane fallacy that a profit-maximizing firm has no  
16 incentive to raise or lower its technology fee.

17 Another question about analysis of inputs, in  
18 principle, the antitrust analysis for a technology input  
19 is not qualitatively different from the analysis of any  
20 other upstream good or service. The demand for the  
21 input is derived from the demand for the final good or  
22 service, and one thing to point out is the  
23 Hicks-Marshall Law of derived demand, which says that  
24 the elasticity of Derived Demand is proportional to the  
25 cost share of the input. It is roughly the cost share

1 of the input times the elasticity of demand for the  
2 output. That will generally lead to a conclusion that  
3 the elasticity of demand is pretty small in magnitude.

4           Indeed, in the Microsoft case, Microsoft made  
5 the argument that if you do this calculation, the  
6 profit-maximizing price for Windows was I think, like,  
7 \$1,500 or something like that, and therefore, we could  
8 not have market power because we are not charging  
9 \$1,500. I think it was an argument that was never  
10 really entirely responded to, but one does find that as  
11 you go upstream, you are going to generally get less  
12 elastic demands, derived demands; therefore, more  
13 potential to raise prices; therefore, more possibility  
14 of competitive effects.

15           Of course, while it implies relatively inelastic  
16 demand for inputs and the ability to affect the input  
17 price, the input price has only an indirect effect on  
18 the final consumer prices, which is why the elasticity  
19 of demand is low. So, it turns around and gets you the  
20 other way. So, upstream analysis can overstate the  
21 ability to affect consumer prices.

22           As you move downstream, though, the question is,  
23 how far downstream do you go? If you go far enough  
24 downstream, almost everything competes with everything  
25 else. If you move all the way downstream, eventually



1 you are competing for the consumer's entire budget  
2 allocation, and whether you are talking about movies or  
3 sports or buying a car or whatever, everything competes,  
4 and the overall elasticity of demand for all goods and  
5 services is one, because you only have so much income.

6 So, it is my view -- my strong view, but it is a  
7 view -- that analysis should take place where the firm  
8 has the ability and incentive to raise or maintain a  
9 price paid for an input or a final good, and the  
10 question should be, is the conduct the type of conduct  
11 that we want to prevent? And if it is, let's analyze it  
12 where the conduct might have an effect and let the  
13 market definition follow from where the conduct could  
14 have an impact.

15 I just have a very quick example to end with of  
16 genetically modified seeds, which express a desired  
17 characteristic, like insect resistance in corn or  
18 tolerance of some herbicide. Do conventional seeds  
19 compete with licenses for seed traits? So, that gets  
20 back to the IP Guidelines definition, where do the goods  
21 come in to compete with the traits? It is a complicated  
22 question, not one I am here to answer, but I would just  
23 point out that these agricultural markets are moving  
24 increasingly to genetically modified traits, which is  
25 now way above 80 percent in soybeans and up above 50

1 percent in corn, and if you are looking at questions  
2 about whether conduct is maintaining high prices for  
3 these characteristics and ultimately higher corn prices,  
4 it is my view that you should look at the trait markets  
5 for where this conduct is expressed, because that is  
6 where the effect could be.

7           It may be that the conduct is not the type of  
8 conduct that should be subject to an antitrust sanction,  
9 but that is the right place to look. It goes back to  
10 the lamp post and the guide post. Let's look where  
11 there could be effects. Let's let the market definition  
12 exercise follow from the inquiry into competitive  
13 effects. Let's not use market definition as a lamp post  
14 to illuminate a problem that may or may not exist.

15           Thank you.

16           (Applause.)

17           DR. CARLTON: Okay, thanks, Rich.

18           Our last speaker is Michael Katz.

19           DR. KATZ: I would like to thank the organizers  
20 for inviting me here, but I do not have time.

21           I want to talk about -- it is a bit of a grab  
22 bag, but I will start about something systematic, which  
23 addresses the question of why delineate relevant markets  
24 in a section 2 case, and what I want to start with is  
25 really the first principle, what is the point of all

1 this, and we really try to answer this question of a  
2 given practice harms competition and consumers, and what  
3 I want to talk about for a few minutes is how that gets  
4 us to talking about relevant markets, and I am going to  
5 talk about at least three things that relevant markets  
6 might be doing to help us answer that question.

7           Okay, so the first one is you can think of --  
8 what you are trying to do is you are defining relevant  
9 markets so you can calculate market shares and  
10 concentrations, and we are doing that because we want to  
11 know whether the defendant or the firm under  
12 investigation, whether the defendant currently has  
13 monopoly power. Now, as everyone has been talking  
14 about, this is where the hypothetical monopolist test  
15 breaks down, so there is an issue there.

16           It seems to me where we have gotten, actually,  
17 in a bunch of the recent cases -- and maybe this also  
18 goes to Andy Gavil's point about somebody showing me a  
19 false positive -- but I think if you look at Dentsply  
20 and Microsoft, there was plenty of expert testimony, but  
21 in the end it just came down to hard core pornography,  
22 the thing is you know it when you see it. People have a  
23 good idea that false teeth are a product and they are  
24 not really worried about a lot of other substitutes. I  
25 mean, there is sewing your lips shut and things like

1 that, but I think in both of those, that was not really  
2 the issue.

3 Now, I want to make a couple of other points  
4 about concentration as an indicator of market power  
5 here. One, if we are going to look at market shares, I  
6 think we really ought to ask ourselves, where did the  
7 market shares come from? Because it matters. Think  
8 about it. In some cases it is because of product  
9 differentiation, and some producers have much more  
10 successful products that match up with consumer tastes.  
11 There can be very different managements of different  
12 producers have different strategies, and one of the  
13 firms decided to have a high-volume, low-price strategy.

14 I think the conclusions one would typically want  
15 to draw about the implications of them for competition  
16 are very different, and so I think it is important to  
17 try to have such a theory, and I think it is often  
18 lacking in antitrust cases. People just talk about the  
19 shares but not what they really mean or where they came  
20 from.

21 The other thing is we want to ask ourselves why  
22 we care whether the defendant currently has monopoly  
23 power, and I will say at least I think one reason is you  
24 can think of it as a one-sided test in a monopoly  
25 maintenance case, which is to say, if you are in there

1 arguing that some particular practice successfully  
2 maintained a monopoly and you come up with a credible  
3 analysis that says the firm had a very low share, that  
4 is likely to undermine the case. Now, it certainly does  
5 not work in the other direction, right? Just because  
6 you have a high market share does not mean you are  
7 guilty of any sort of offense at all and it may be that  
8 you got it because you deserve it. Okay, so that is a  
9 particular use.

10 Now, I want to distinguish that from some  
11 others, because I think they often get rolled together,  
12 and they really are different, although they are  
13 related. Okay, so another one that is related is  
14 concentration as a screen for potential harm to  
15 competition. Now, in a sense what I just said, it is a  
16 screen, the one I just said, which is you are saying,  
17 look, if they have a tiny market share, is it really  
18 plausible that they have harmed competition  
19 significantly in the past, but I also want to worry  
20 about it going forward, and there it is not at all  
21 clear -- in fact, I think it is not a general  
22 proposition -- that you want to look at concentrations  
23 to understand the potential for harm to competition,  
24 because if you are looking at a case on a going-forward  
25 basis, sometimes the current share of the defendant is

1 relevant, but other times, it is not, right? You are  
2 not worried about their share now. You are worried  
3 about what their share is going to become or what the  
4 state of competition will become going forward.

5           Okay, so, notice I hedged it. I am an  
6 economist, so lots of "on the one hands, but on the  
7 other hands." So, in some cases where you are looking  
8 on a going-forward basis, current shares may be largely  
9 irrelevant. In other cases -- and I have the example  
10 here of exclusive dealing -- even when you are looking  
11 on a going-forward basis, market shares could be  
12 relevant, and I would think that would have been true in  
13 Dentsply.

14           Now, as it turns out, in Dentsply, it was  
15 looking backwards, but if one had brought the case much  
16 earlier, I think what one could have done is say, look,  
17 Dentsply has this large market share, and I think by any  
18 sensible measure they had a huge market share, and we  
19 could argue about the source, but let me just  
20 hypothesize here without anyone arguing that it is  
21 because they did have teeth that were more popular and  
22 more attractive, that there was something about their  
23 product that they did have an advantage, and others were  
24 not able to imitate, and then you could use that fact to  
25 say, okay, that is going to tell us something about how

1 exclusive dealing is going to work going forward, and  
2 even exclusive dealing with at will contracts, which is  
3 what was present in Dentsply, because this one firm's  
4 products were such a better fit with consumer tastes,  
5 that if you have exclusive dealing, that is where the  
6 dealers are going to go.

7 So, in that case, concentration would be  
8 relevant as a screen or a way to think about what is  
9 going to happen but through a much more complex chain of  
10 reasoning than to just say, well, they have a high  
11 market share; therefore, they must have market power.  
12 It is really a very different kind of analysis, and that  
13 is the kind of analysis that I think needs to be done.

14 Okay, the third one -- and actually, this is the  
15 one that is my favorite -- is say, look, we need to  
16 identify relevant markets, because if we are talking  
17 about harm to competition, we need to have some sense of  
18 who the competitors are, and actually, I think that is  
19 what the role should be in the merger analysis I will  
20 say as well, this really should be about identifying the  
21 competitors and then seeing where that takes us in terms  
22 of the but-for world, what needs to be the scope of the  
23 but-for world, and this is an unfashionable view,  
24 because it is low tech and it does not drive you to come  
25 up with algorithms, but I think it is important to

1 remember in the end, this really is what we are trying  
2 to do.

3 We are trying to figure out who are the  
4 competitors, because then we can ask, does this practice  
5 harm them? And if it does, does that matter for  
6 competition and does it matter for consumer welfare?  
7 Okay, so again, I think this takes us in a somewhat  
8 different direction, and notice, in this one, you may  
9 not be worrying about concentration very much directly  
10 at all.

11 Also, since I had promised -- but so far have  
12 not done it -- the organizers that I would talk about  
13 innovation, let me say a little bit about that. When  
14 innovation competition is really significant, and this  
15 is not a point that is new to me by any stretch of the  
16 imagination, current market shares may not tell us very  
17 much, right, the extreme model being Schumpeterian  
18 competition, where we see a string of product market  
19 monopolies, but the real way competition works in the  
20 industry would be that you have firms that come in with  
21 major innovations, become the new monopolist, but then  
22 there is this battle for the next round of drastic  
23 innovation. If you are looking at a market like that,  
24 looking at market shares is not going to tell you very  
25 much.



1           Okay, a couple things about market definition  
2           and uncertainty. First off, we have talked about burden  
3           shifting a little bit. As everyone in this room who  
4           works for the Government knows, right, meeting the  
5           market definition burden can be difficult, and that is  
6           true even if you do not have innovation, and I will come  
7           back to innovation in a minute. One of the difficulties  
8           is when courts say we want a zero-one boundary. Every  
9           firm is either in the market or they are out of the  
10          market; none of this wishy-washy stuff.

11          The problem with that is it can be really hard  
12          to do. I know Oracle is a merger case, but it is really  
13          striking because it is a case where Judge Walker said,  
14          all right, look, here are the economics of why you  
15          cannot draw zero-one boundaries. You have got product  
16          differentiation. You have got a continuum of products.  
17          There is no way there is going to be a sensible  
18          boundary. He did not say, "And oh, guess what, that  
19          means you lose."

20          I mean, I think Judge Walker was right about the  
21          first part. It is just the notion that that is where it  
22          takes you I think is a little troublesome. It is  
23          particularly troublesome as well because if you believe  
24          that these are differentiated product markets and you  
25          believe competition is localized, then you really have

1 to ask yourself, why are we worrying about a broader  
2 market anyway? I mean, what is the relevance of this  
3 alleged relevant market if what really matters is  
4 defined structure?

5 So, it seems to me that where we have gone with  
6 a lot of -- just to jump back to mergers for a second  
7 where I think there is a broader lesson here -- with  
8 mergers, is worrying about unilateral effects cases in  
9 markets with differentiation -- and everyone seems to  
10 have conveniently forgotten that you can have a  
11 unilateral effects case with homogenous products -- but  
12 we have spent all this time worrying about market  
13 definitions in precisely the wrong places.

14 Now, although this gets worse if you have  
15 innovation, because you can have things constantly  
16 changing, you can have products -- the characteristics  
17 of products are changing, I just want to make two points  
18 on this and then move on quickly. One, there are a lot  
19 of people who seem to be of the belief that what  
20 innovation means is markets are constantly getting  
21 broader, okay, and there is a set of people who will  
22 say, look, you have got all these things, you have got  
23 innovation, markets are always going to be so broad  
24 because new products can keep coming in, that really,  
25 there is nothing for antitrust to do. I would just like

1 to remind people that, in fact, markets could be getting  
2 narrower, because these products are evolving, they are  
3 moving targets, and it is quite possible that some  
4 products or the producers of those products are falling  
5 behind in terms of innovation and they are dropping out  
6 of the relevant market.

7 Okay, the point I have already made, that if you  
8 are looking at differentiated products and then you  
9 throw in the complexities of innovation, you just really  
10 may make it impossible to meet the burden. As we have  
11 talked about, since I think there is a fairly broad  
12 consensus, you do not really need to have a rigid market  
13 definition. That is unfortunate, but that is how a case  
14 would be decided.

15 Now, I have to have a diagram. So, what this  
16 one shows, just very quickly, suppose there is  
17 disagreement on the scope of the relevant market here,  
18 and I am interested in a case where I will just suppose  
19 that one has beaten up on two, okay, these are suppliers  
20 markets, and this line represents some notion of product  
21 differentiation, and there is a debate. It is hard to  
22 know whether the market boundaries are -- the ones who  
23 have the narrow subscripts, so only include one and two,  
24 or they have the broad, and then they would include  
25 producer three as well. Suppose we get the debate down

1 to that level. This is a dramatic oversimplification.

2 Well, you can imagine a court, Judge Walker  
3 saying, "Look, Government, you cannot tell me whether it  
4 is the narrow definition or the broad one with  
5 certainty, so you lose." But suppose it does not make  
6 any difference whether you include three in the market,  
7 okay, to what you think are the competitive effects,  
8 then why does it matter that you cannot say which one is  
9 which, okay? So, what you really want to ask is not  
10 whether or not the plaintiffs can prove a market  
11 definition with certainty, but you want to ask can they  
12 tell you, "Look, we know well enough where it matters  
13 with a high degree of certainty."

14 So, the approach to this would be to then ask,  
15 "Where does the dividing line matter," okay? Go back to  
16 this, "Does it matter whether we include five in or  
17 not?" If it turns out what is critical in the end is  
18 whether three is in the market, let's fight about that.  
19 Let's not fight about, no, you have to come up with the  
20 definition.

21 Okay, a quick thing on decision theory. I have  
22 a pretty picture, I have to show it. What this is  
23 saying is -- I just want to make the following point, I  
24 probably will not actually go through the picture, so  
25 just admire it while I talk. It was not easy drawing

1 this on the train while it was jerking around -- but is  
2 the following, that there is a lot of focus, I think, in  
3 court cases, at least, in actual legal decision-making  
4 on doing things like asking are probabilities above  
5 certain thresholds or is one probability higher than the  
6 other, something like that.

7 This would be a diagram where if you weigh  
8 evidence, you would just ask, is the probability of harm  
9 bigger or less than the probability of efficiencies?  
10 So, you would get in that red zone, because that's where  
11 the probability of harm,  $P$ , would be viewed as being  
12 higher than the probability of the efficiencies,  $Q$ , and  
13 you would just sort of -- that is one interpretation of  
14 weighing the evidence. There are others, I will note,  
15 and if I had a longer time, I would tell you some of the  
16 others.

17 Now, but if you try to balance the effects, you  
18 do not just look at the probabilities. You have also  
19 got to look at the magnitudes, and I have given the  
20 example here where the harms, denoted by  $H$ , are bigger  
21 than the efficiencies. So, in fact, you want to condemn  
22 not just practices where the harm is more likely or  
23 equally likely as the efficiencies. You actually want  
24 to condemn some where the harm is less likely, but the  
25 problem is, well, it is less likely, but when it

1 happens, it is a worse thing, and that is where you get  
2 that purple area.

3 I would say in the end, since we are worried  
4 about effects, the right thing to do, and if we do all  
5 this stuff, would be to condemn this bluish-purple area  
6 plus the red, but if you simply weigh the evidence, you  
7 are only going to get rid of the red. So, you are going  
8 to -- if there is enforcement, you are going to have  
9 false negatives. So, I think what is important in all  
10 of this, and there are many other interpretations of  
11 this, but the central point is I think we do have to  
12 worry about magnitudes more than we have in the last --  
13 okay, are you going to unplug this? This is like the  
14 Academy Awards, they start playing the music.

15 Innovation, I will say one thing in support of  
16 innovation markets as a broad concept, because certainly  
17 they have been controversial in terms of actually using  
18 them, but if we are worrying about markets where  
19 innovation competition is really critical, then we need  
20 to worry about what is driving innovation, who the  
21 potential innovators are, and looking at markets in a  
22 product market may not tell you very much about it. It  
23 may be much more informative to look at the distribution  
24 of R&D capabilities and assets.

25 As some people, one of them sitting near me,

1 have pointed out, that can be really hard, because it  
2 may not even be in this industry, but that is  
3 conceptually the right thing to do, and so I think we  
4 ought to be asking ourselves, how do we get there? If  
5 we conclude it is too hard to do, fine, but I don't  
6 think it makes sense to say -- and persons near me  
7 didn't say this -- "Oh, it is too hard to do; therefore,  
8 let's go and do something else that does not make any  
9 sense but is easier." I think we want to keep in mind,  
10 though, that the R&D capabilities and the distribution  
11 of the assets there may be much more important than  
12 current market shares in terms of understanding  
13 innovation.

14           Okay, last thing, which does not have anything  
15 to do with anything except people always screw it up. I  
16 will make what has actually turned out to be a  
17 controversial statement in practice, that geographic  
18 markets are markets, by which I mean since they are  
19 markets, they have buyers and sellers, okay? In  
20 practice, at least my experience has been that people  
21 often forget about the buyers part of that description  
22 of markets, and then if we are going to talk about  
23 geographic markets, we need to think about the buyers  
24 and where they are and the sellers and where they are.

25           Now, in some markets, in the end, there may be

1 global markets and those do not matter, but other times  
2 you want to ask something like, particularly in  
3 retailing, say, or certain kinds of manufacturing, you  
4 would want to say, let's look at a set of customers in a  
5 particular city and ask what producers, and in  
6 particular the producers' plants, can serve those  
7 customers, and look at it that way.

8 Now, that may mean that a firm is in a lot of  
9 different geographic markets, and a single plant, by the  
10 way, could be in different geographic markets  
11 simultaneously, which drives people crazy, but if you  
12 want to think about what is really going on and take  
13 markets seriously, you have got to remember, markets are  
14 bringing together buyers and sellers, so we need to  
15 discuss or describe the locations of both of those.

16 With that, I will stop.

17 (Applause.)

18 DR. CARLTON: Okay, thank you. The person close  
19 to you says, "Thank you very much."

20 Okay, I would like to ask the panelists some  
21 questions. We have about 45 questions left, and I have  
22 a series of questions. I have about ten questions. I  
23 do not know if we will be able to get through them all.  
24 What I will do is I will ask the question, and then I  
25 will ask two of you to comment. If you could keep your



1 answers relatively brief, that would be good. If  
2 someone on the panel who we have not asked feels they  
3 want to comment, they should do so, but since there is  
4 an opportunity cost, that just means you may not get to  
5 answer a later question.

6 Here is what it seems to me that the purpose of  
7 these hearings are. One, we want to define market  
8 power. Can we agree on a definition? If we can, do we  
9 think defining the market and then taking market shares  
10 helps us in a section case? Then, what are the hard  
11 questions where we think that that may or may not help?

12 Then the ultimate question really is -- and this  
13 I will ask everybody to answer, it will be the last  
14 question -- do we really need market definition and is  
15 it more of a hindrance than a help?

16 So, let me just start off on first asking the  
17 question about market definition. In the legal  
18 literature and in the cases, they stress not just the  
19 ability to control prices, which is what economists  
20 focus on, but they always add, "or the ability to  
21 exclude competition," and it is that second prong I want  
22 to focus on for a second.

23 I understand -- and Andy spoke a little bit  
24 about this -- that a joint venture can get together and  
25 exclude people. Let's just talk about single-firm

1 behavior, and I am interested, in particular, from both  
2 Andy's point of view and Joe's point of view, with their  
3 sort of combined economic/legal backgrounds, if they  
4 could comment on whether they think the exclusion prong  
5 of the market power definition that is used in legal  
6 cases is useful. Do we need it? Can we do without it?

7 For example, can we do without it by saying,  
8 "Well, it is the ability to control price, and if you  
9 say keeping it above the competitive level, obviously  
10 the competitive level is the level that arises when you  
11 do not exclude competition." If we can simplify the  
12 definition, it seems to me that helps things rather than  
13 complicates things. So, is your view that we need that  
14 second prong, exclude competition, in the definition of  
15 market power or not?

16 So, let me first ask Andy and then I will ask  
17 Joe, and if you could keep your answers sort of  
18 relatively brief, that would be good.

19 DR. GAVIL: I think in exclusion cases, the  
20 answer is yes, but it winds up being a first step. The  
21 ability to exclude competition -- I guess the "or" is  
22 the problem. Why do we have monopolization? We have  
23 monopolization cases because we want to prevent not just  
24 any exclusion of competition; it is exclusion of  
25 competition followed by the ability to either maintain

1 price, maybe raise price, but the two to me go hand in  
2 hand.

3 In any section 2 case, the first step is going  
4 to be evidence of some exclusion, but I do not think you  
5 can stop there and conclude from that that there would  
6 automatically be monopoly power. You have to ask the  
7 second question of whether or not the exclusion will in  
8 some way facilitate the maintenance or the enhancement  
9 of the market power. So, I think it winds up being  
10 circular. You do come back to power over price.

11 DR. CARLTON: Okay, Joe?

12 MR. SIMONS: I agree with what Andy said, and  
13 also, just to follow up on what Rich said about the  
14 guide posts and the lamp posts. You know, what you see  
15 in the case law is an example of a lamp post. It is not  
16 an example of a guide post. That kind of definition is  
17 drawn generally from whatever you guys refer to in the  
18 equilibrium analysis or partial equilibrium analysis or  
19 whatever it is, and they just moved it over and said,  
20 "Here, this is what we are going to do," without  
21 thinking about why we really want to do it.

22 The statute talks about monopoly, so you tend to  
23 have to have a big share and so it is natural that a  
24 share requirement gets imported into the law. But it  
25 does so without thinking, and so I do not think that

1 focusing on that question based on the case law is going  
2 to be terribly helpful.

3 I think Andy is right, you want to focus on why  
4 are we asking this question, what are we trying actually  
5 to prevent, what is the goal.

6 DR. CARLTON: Okay, I think I agree with that.  
7 I think probably that is a fair summary of what you  
8 said, that I think both of you say we can get rid of  
9 that second prong as long as you keep your eye on the  
10 ball. In effects cases, obviously you have done  
11 something bad, and then did you raise price. So, if you  
12 are wanting to define market power alone, it is whether  
13 you can raise the price above what it would otherwise  
14 be.

15 MR. NELSON: Or prevent it from falling.

16 DR. CARLTON: Or prevent it from falling, that  
17 is right.

18 DR. GAVIL: I think the exclusion does tell you  
19 something. I would not eliminate it entirely. I think  
20 the problem is it does not tell you whether or not you  
21 have monopoly power, but it is like the first red flag.  
22 It is the first guide post that tells you there may be  
23 reason to be concerned about a particular situation, but  
24 you cannot stop there. You have to ask the second  
25 question.

1           Even going back to Salop and Krattenmaker, the  
2 title of the article was Raising Rivals' Costs to Obtain  
3 Power Over Price. So, the two really do go hand in  
4 hand, but the first sign of a problem may be the  
5 evidence of exclusion.

6           DR. CARLTON: Right, but what is a mechanism to  
7 achieve the control of price? I agree, it is important  
8 to have both, but I am just trying to distinguish the  
9 two. One of the things that goes on in a section 2 case  
10 is you define markets and you have exclusion -- and I  
11 will come back to this later -- and the question is how  
12 you link the two. I am trying to keep them separate for  
13 a second.

14           MR. SIMONS: I think in what Krattenmaker and  
15 Salop do with their article is they are linked. It is  
16 the exclusion that gives you the power over the price.  
17 What is the impact of the exclusion? Not kind of in a  
18 general sense, have you been able to exclude people, all  
19 right? Because maybe you have because you have such a  
20 terrific product or you have a patent or whatever it is.  
21 That is legal. The question then becomes, did you do  
22 something in addition to that that may not be so legal,  
23 and does that give you power over price?

24           DR. CARLTON: Right.

25           DR. GAVIL: Think of instances where the act of

1 exclusion raises entry barriers.

2 DR. CARLTON: Yes.

3 DR. GAVIL: That leads you to the second part of  
4 it.

5 DR. CARLTON: Yes and no. What that tells you  
6 is that but for the act, which we are trying to claim is  
7 illegal, the price would have been lower, and therefore,  
8 you have the power to set price above the but-for price.  
9 It is just defining what the but-for price is.

10 Okay, let me go on, because I am going to come  
11 back to this benchmark point. The definition that  
12 economists use a lot is that market power is the ability  
13 to set price profitably above the competitive level,  
14 presumably by a significant amount, for some significant  
15 amount of time. So, first, I have two parts to this  
16 question, and I am going to ask Phil and Larry.

17 Assume that there are constant returns to scale,  
18 so competition is possible. So, first, do you agree  
19 that the definition I gave you is a reasonable one --  
20 put aside whether it is implementable, but is it a  
21 reasonable one -- and if so, what is a significant  
22 amount of the price increase and what is a significant  
23 amount of time?

24 In particular, when you are answering, if you  
25 could talk about why we do not pay attention to dead

1 weight loss and why we just talk about numbers. I mean,  
2 we are economists, and 5 percent, 10 percent, we know  
3 that may not be meaningful depending upon the size of  
4 the market. So, if you could just address those.

5 DR. WHITE: Are you looking at me? Look, you  
6 know, where do 5 and 10 percent come from? As Bill  
7 Baxter used to say, from these (indicating hands), and  
8 there's nothing magical about that. You know, it partly  
9 would also depend on how much noise you think is out  
10 there protecting ourselves against error that might be  
11 harmful. So, the real answer -- the first part is yes,  
12 under constant returns to scale, a price significantly  
13 above marginal cost, sustained for a sustained amount of  
14 time, would in my mind constitute an exercise of market  
15 power, and how much and for how long, I do not know.

16 Sure, 10 percent sounds like a number to be  
17 thinking about and two years sounds like a number to be  
18 thinking about, but I have just picked those out of the  
19 air, and I do not have any further basis.

20 DR. CARLTON: Okay, let me just say one thing.  
21 My preference would be it is probably better -- even  
22 though it is hard to choose a number, someone is going  
23 to choose a number, so you should think, as to your  
24 willingness to choose a number, would you rather some  
25 random judge choose a number or this panel? So, that is

1       why I am asking.

2               DR. KATZ:  I mean, I disagree with the premise.  
3       Why should you choose a number?  I am almost  
4       certainly -- if you thought the court was going to do  
5       enough of the analysis -- and we would have to talk  
6       about the cost of the court and the time they have --  
7       but almost certainly you would say the number depends on  
8       the market.  I mean, there are some markets where  
9       worrying about a price change within 5 or 10 percent, I  
10      mean it is completely lost in the noise, because the  
11      prices are changing 40 percent every year, so it does  
12      not mean a 10 percent price increase could not matter,  
13      but it becomes less plausible you could actually tell.  
14      In other markets, it might be that you could reliably  
15      predict a 3 percent price change.

16             DR. CARLTON:  Following that same logic,  
17      wouldn't you be concerned about a 1 percent change in a  
18      market that is huge?

19             DR. KATZ:  If you believed you could actually  
20      make reliable predictions at that level, yes.  So, I  
21      think you need to look, as you were saying, at the  
22      magnitudes of the effects, and some of it comes within  
23      when do you want to bring cases and how to allocate  
24      resources and then also the various characteristics of  
25      the market that are going to affect the reliability of



1 your projections and whether you think that you really  
2 can discern at those levels, but I think it would be  
3 pretty clear that holding aside -- which is obviously a  
4 big thing to hold aside -- the various sorts of  
5 processing costs, there is no reason to think there is  
6 one right number, and, in fact, there certainly isn't.

7 DR. CARLTON: The question is, should we give  
8 any guidance to the courts when they are trying to  
9 decide whether a firm has market power, and if you just  
10 say it is up to the discretion of the judge based on a  
11 lot of things -- I mean, I agree with you, it is hard to  
12 come up with one number. The question is, is it better  
13 leaving it completely to the discretion of the courts,  
14 or should we not -- I think one of the advantages of the  
15 Merger Guidelines, even though they make the point that  
16 the 5 percent is just a suggestion, is that it has  
17 focused thinking and clarified thinking. So, I agree  
18 with everything you have said, but in light of the  
19 decision-making of the court process, there can be a  
20 benefit to articulating some standards, maybe flexible  
21 standards.

22 DR. KATZ: I would agree with that, but I think  
23 a question would be -- and this is just thinking off the  
24 top of my head -- could you say something like -- have  
25 some sort of relatively easily observable data, say like

1 the annual price changes or something, or try and do  
2 something that says that the standard you use should be  
3 proportional to some characteristic in the market? We  
4 would have to think a lot about what that is, and I  
5 think ideally, for the reasons you bring up, it would be  
6 something fairly mechanical, but it would still be an  
7 improvement over a one-size-fits-all.

8 DR. CARLTON: Rich?

9 DR. GILBERT: Well, I certainly agree that the  
10 number, however you define this number, depends on the  
11 nature of the conduct, the efficiencies that can be  
12 presumed to go along with that conduct, and maybe the  
13 size of the market and all of that, but I also think  
14 there is the case that can be made for shifting the  
15 inquiry to something like the firm-specific elasticity  
16 of demand, which often can be measured in many  
17 instances. I think Greg has pointed this out in some of  
18 his writings.

19 It is not that hard to say if the elasticity of  
20 demand is bigger than 10, maybe we shouldn't be worried  
21 about this. On the other hand, if it is in the range of  
22 2 to 3, maybe we should be worried about this.

23 DR. CARLTON: Yeah, that raises a point I am  
24 always puzzled about, that if you are thinking about  
25 what is a magnitude that is important, an elasticity of,

1 say, 20, which everybody would say is a really high  
2 elasticity, that gives you a 5 percent upcharge over the  
3 competitive price. So, that should tell us something  
4 about our intuition versus sort of practical --

5 DR. GILBERT: Well, on that, maybe I am  
6 differing from other people, I think of that 5 percent  
7 rule as being a derivative, not an absolute amount. So,  
8 we ask, if quantity goes down by 5 percent, will the  
9 price go up by 5 percent, that sort of thing, and rather  
10 than because we are really worried about the price going  
11 up by 5 percent. Now, some people I know would disagree  
12 with that and would say that that 5 percent is a  
13 threshold of concern. I think of it more as an  
14 elasticity test.

15 DR. CARLTON: Okay.

16 MR. NELSON: Since I was one of the original --

17 DR. CARLTON: I am going to give you another  
18 question, okay? It is actually a harder question now.  
19 We are going to move on to something else. That was an  
20 easier question. If you remember, that was premised on  
21 constant returns to scale. So, it could actually define  
22 a competitive price.

23 Let's suppose now that I am in an industry where  
24 there cannot be competition. There is a fixed cost of  
25 entry. There are constant returns to scale, and it is

1 Cournot competition, okay? What is the meaning of that  
2 common phrase that we use, can you profitably price  
3 above the competitive level? What in the world should  
4 we take as the competitive level in that situation? Is  
5 it the zero profit equilibrium or is it price equaling  
6 marginal cost?

7 So, let's see, maybe Phil, if you want to take a  
8 crack at that.

9 MR. NELSON: Well, one of the things that sort  
10 of concerns me about taking sort of the current level as  
11 opposed to something like marginal cost is you do have  
12 some of these monopolization cases that are really  
13 entrenchment theories, and is the question whether the  
14 entry is going to drive you significantly back towards  
15 competition, or this guy already has some market power,  
16 and he is going to --

17 DR. CARLTON: Try to define the market  
18 equilibrium, free entry, fixed costs, constant returns  
19 to scale, Cournot equilibrium, do we want to call that  
20 market power?

21 MR. NELSON: I guess I am saying that to answer  
22 that, you want to know sort of what your benchmark is as  
23 to where you're going.

24 DR. CARLTON: Right, that is what I am asking  
25 you.

1           MR. NELSON: Yeah, and what I was going to say  
2 is that I think you would start to look, as N goes up,  
3 what happens to the equilibrium price? Then as N gets  
4 high enough, are you still at a price where somebody  
5 could make an economic profit? I mean, you are going to  
6 want to see if that is a tenable number of firms and  
7 start to use something like that as the equilibrium,  
8 which is higher. It is going to be a lower price and  
9 define market power in some circumstances where you  
10 might not find it if you are at your starting point.

11           DR. CARLTON: So, the point of the question is  
12 to show that there is a difficulty in defining market  
13 power when you cannot define the competitive price. You  
14 can define a rate of return, and you can define marginal  
15 cost in this example and prices above marginal cost in  
16 this example, but profit is zero, and there seems to be  
17 a complete ambiguity between the willingness of people  
18 to distinguish which of those two definitions they are  
19 using.

20           Is it price above marginal cost that is market  
21 power? Is it rate of return above a competitive level,  
22 or which of the two, or are those two different things?  
23 They obviously from an economic point of view are two  
24 different things, yet often, in the writings and in case  
25 law, they in my mind do not get distinguished.

1           MR. NELSON: I mean, yeah, you want to have  
2 profit -- you want to be able to make a monopoly profit.  
3 I mean, if you have got easy entry, as some of the  
4 different -- you know, if you don't have any profits,  
5 then they are not going to have enough -- but I --

6           DR. CARLTON: Larry, did you want to say  
7 something?

8           DR. WHITE: But why would we be interested in  
9 your hypothetical? If it is somebody coming in and  
10 saying, "That guy is charging an outrageously high  
11 price, Judge, find him guilty of a section 2 violation  
12 and mandate that he charge a lower price," we do not see  
13 that all that often, but that would be a problem. If it  
14 is, "Judge, that guy has excluded me from offering my  
15 rivalrous product, and had he not excluded me, I could  
16 have come in and the price could have been lower,"  
17 that's a different --

18          DR. CARLTON: I agree, but that is mixing  
19 together two different questions. The first is, what is  
20 the effect of this action? If you can answer that  
21 question, you have answered the section 2 -- you have  
22 resolved the section 2 issue.

23          DR. WHITE: And then we do not have to worry  
24 about it.

25          DR. CARLTON: And then we do not have to worry

1 about market definition; however, the way the courts  
2 seem to use market definition in section 2 cases is not  
3 like that at all. Courts seem to do the following:

4           Unlike a merger context where you ask, as a  
5 result of a merger, is market power going to go up, the  
6 courts define a market and then look to define market  
7 share. Courts do it. They do not look at the change in  
8 the market shares that arise as a result of the bad act.  
9 They do not do that. That would be an analogy to a  
10 merger case.

11           Instead what they do is they ask, is there  
12 market power? They do not ask about the change in  
13 market power, but they ask, is there market power? They  
14 use that as a screen whether to then further  
15 investigate, and that distinction, that asymmetry  
16 between a merger case and a section 2 case, I think  
17 leads to peculiar discussions, but it also I think leads  
18 to exactly why I am asking this question, which is, if  
19 the courts are going to go this route and use market  
20 definition -- I agree with you, Larry, if you do an  
21 effects-based analysis, you can solve the problem -- but  
22 the first question the court is going to be asking, is  
23 there market power, and I am just trying to figure out,  
24 can we even define what we mean by that in this Cournot  
25 example?

1           MR. SIMONS: I think what you want to ask is why  
2 are we doing this, why are we engaged in an exercise,  
3 before you can even think about answering the question.

4           DR. CARLTON: This firm has been sued, there is  
5 a bad act, and the first question is, does he have  
6 market power? And I am trying to find out -- I cannot  
7 answer that -- begin to answer that question unless we  
8 can agree on a definition of market power. So, is the  
9 definition price above marginal cost or is the  
10 definition rate of return above the competitive level?

11           Mike?

12           DR. KATZ: The problem is if you are going to  
13 say this has to be a screen that works for everything,  
14 then the most useful definition of market power would be  
15 does the firm have at least one employee or something  
16 that is equivalent of it so we throw this screen out,  
17 because what Larry has pointed out -- I think what in  
18 most cases makes sense is something that says -- and  
19 actually, I make a different distinction, and I think,  
20 actually, a lot of economists writing not as part of  
21 antitrust make a different distinction. I think a lot  
22 of people, economists, would say that market power would  
23 be facing downward-sloping demand curve and not having  
24 it perfectly elastic, which then would end up giving you  
25 the profit-maximizing price of that firm above marginal



1 cost. I think that is a useful definition of market  
2 power.

3 Then I try to reserve monopoly power for being  
4 two parts. One, that you have a lot of market power,  
5 which is to say the price would be -- and again, I will  
6 be vague -- but significantly above marginal cost, and I  
7 would typically put in a test saying for I think most  
8 purposes or a lot of them, we do care whether or not the  
9 price is above average cost, whether or not there are  
10 profits, but what Larry has pointed out, I think  
11 correctly, is that test does not always work, that if  
12 what you are worried about is somebody who is in there  
13 now and is just breaking even but is narrowly keeping  
14 all sorts of more efficient entrants out who could make  
15 a profit, I think in that case, saying, "Well, look,  
16 they are not making money, there can't be a problem,"  
17 would give you a misleading answer.

18 MR. NELSON: That was my standards example I  
19 gave in my opening talk.

20 DR. CARLTON: I think, again, that is really  
21 asking the but-for price; in other words, price may  
22 equal marginal cost and price may be above average cost  
23 in the present environment, but but for the bad act,  
24 that would not occur, okay?

25 The distinction you make between price above

1 marginal cost and then whether the rate of -- the price  
2 above average cost, the rate of return is above the  
3 anticipated return, is exactly the distinction that I  
4 made between market power and monopoly power. It is a  
5 logical distinction. I am not sure -- we may be the  
6 only two people who make that distinction, because I do  
7 not see the legal cases going in that direction.

8           So, I guess I do have a question, and I think it  
9 is a relevant question, as to whether the distinction  
10 between monopoly power and market power that we do see  
11 in the cases, is that a useful distinction, and is it a  
12 useful legal distinction? Is it a useful economic  
13 distinction?

14           So, maybe, Andy, you could answer that and maybe  
15 Rich.

16           DR. GAVIL: Yeah, one point I wanted to make  
17 earlier and I think I can make it now in answering the  
18 question, I think historically the association of market  
19 power and monopoly power as being different things was  
20 linked to market share. It was linked to circumstantial  
21 evidence as the basic mind set that we used to approach  
22 cases, and I think a concrete example of this is the  
23 Supreme Court decision in Copperweld, where it says --  
24 it is known for the parent/subsidiary enterprise  
25 conspiracy issue, but it has a very interesting

1 discussion of the relationship between section 1 and  
2 section 2, and it says, "An unreasonable restraint of  
3 trade by a single firm is not reached under section 2,  
4 and therefore, the drafters of the Sherman Act left a  
5 gap between section 1 and section 2, and the implication  
6 was that for a section 2 case, you need something more."  
7 At that moment in time, the "something more" was the 70  
8 percent or more market share as opposed to the 40 to 60  
9 percent that was typical in rule of reason cases.

10 If you let go of the commitment to the Alcoa  
11 framework and the market share associations and start  
12 thinking about market power in different ways as  
13 expressing itself in different ways, that kind of mind  
14 set of distinguishing market and monopoly power based on  
15 market shares goes away, and I think that that would  
16 make a big difference in how we think about antitrust  
17 generally.

18 But you have said it several times, Dennis, and  
19 it is clearly the case, that courts say, "Okay, the  
20 first element under section 2, do you have monopoly  
21 power?" On your no profit example, if I could just  
22 throw in, what if the purpose of the conduct was to make  
23 that firm profitable and that is what it was trying to  
24 do? So, currently it is not profitable, but the whole  
25 point of the conduct, maybe it affects entry barriers,

1 was that they are trying to get profitable by engaging  
2 in conduct. Again, I think it shows the link between  
3 the conduct and the power increase.

4 DR. CARLTON: Rich?

5 DR. GILBERT: Yeah, if I can answer this, as has  
6 been said before, in some sense I subscribe to the  
7 argument that monopoly power is a lot of market power,  
8 but it is also market power that is durable. Now,  
9 whether you define durable market power in terms of the  
10 ability to raise price above average cost, the ability  
11 to maintain price above average cost, or the ability to  
12 maintain price above long-run marginal cost, I do not  
13 think that is really critical. To me, it is the ability  
14 to exclude, and as you have noted, Dennis, yourself,  
15 that when you are talking about exclusion, obviously it  
16 also depends on thinking about entry barriers, and then  
17 when you think about entry barriers, you have to think  
18 about what would happen in the market if entry were to  
19 occur.

20 So, if you had an extremely competitive market  
21 post-entry, maybe a little bit of exclusion is enough to  
22 maintain a monopoly position, but I think the key issue  
23 is the ability to exclude is important to me, because it  
24 says something about the ability to maintain price above  
25 some measure of long-run profitability of an efficient

1 competitor.

2 I want to add one other comment that I think is  
3 related to all of this, which is we are very good when  
4 we talk about impacts on competition to understand that  
5 impacts on competition is different from impacts on a  
6 competitor, I think we have learned that one, but when  
7 we talk about section 2 cases, we are often talking  
8 about the market share or monopoly power of a single  
9 firm. Shouldn't we be talking in many of these cases,  
10 at least, if not all of them, about the power in the  
11 market, not just the power of this firm, because  
12 obviously if the firm reduces supply so that its market  
13 share is below the Alcoa threshold, but in doing so,  
14 raises market power generally in the industry, that is a  
15 problem, and we want to look at that, not just what the  
16 firm's market share is or focusing on the firm.

17 Now, if you did this firm-specific residual  
18 demand analysis, then you pick that up by looking at the  
19 elasticity of the residual demand. So, I think it is  
20 all right in that context.

21 DR. CARLTON: Let me go back to something that  
22 sort of was a common theme in some of the presentations.  
23 Let me restate it as follows: It really has to do with  
24 what the benchmark price is.

25 If you look at a firm in a section 2 case and it

1 is engaged in a bad act, can you then ask, "Well, does  
2 that firm have market power," which is what the courts  
3 first ask, and if the answer is no, they throw it out.  
4 In order to answer that question, you have to ask,  
5 "Well, what would the price --" depending on your  
6 definition of market power, you want to ask, "Does the  
7 firm have market power?" Whatever your definition is,  
8 whether it is pricing above the competitive level after  
9 the bad act, are they pricing above the level but for  
10 the bad act, whatever definition you want to use, and I  
11 think it is the latter definition that makes more sense,  
12 it is not obvious why market shares and market  
13 definition help you answer that question, because if you  
14 know the current price and you knew the benchmark price,  
15 it is just a comparison of two prices. So, calculating  
16 market share in that case does not advance the ball.

17 If that is the typical case that we see in  
18 section 2, what really are we talking about when we are  
19 doing market definition? Are we really doing an  
20 analytic economic exercise, or are we doing something --  
21 or are the courts doing something much more -- I don't  
22 want to say sensible, but much more using common sense,  
23 which is there are five guys doing the same thing, don't  
24 bother me, and they're just using their common sense.

25 Now, how you define "five guys doing the same

1 thing" may be hard, but it seems to me that is what a  
2 lot of courts are doing, and I am wondering if we are  
3 worrying too hard about defining markets in cases where  
4 market definition is just this seat-of-the-pants thing  
5 that the courts then use, and as long as they understand  
6 it is real seat-of-the-pants, don't bother me with  
7 details about market shares and get on to your  
8 competitive effects analysis.

9 So, maybe, Joe and Mike, you could comment on  
10 that.

11 MR. SIMONS: Yeah, I think that what the courts  
12 will do is not just say, well, let's get on with it and  
13 let's get to the competitive effects. It is a real  
14 screening event, a big one, and it also seriously  
15 impacts what happens when lawyers counsel their clients.  
16 If there is some chance that your client is going to be  
17 deemed to have a big market share, at least most lawyers  
18 I know will give advice that is much more conservative  
19 than if their shares are 30 percent. So, it makes a big  
20 difference in the real world.

21 I think the judges do focus on it, and it is  
22 important in court now, and there is a serious question  
23 in my mind about how important it should be, certainly  
24 with respect to how the Antitrust Division and the FTC  
25 exercise their prosecutorial discretion -- whether they

1 really need to get hung up on this or whether they  
2 really need to make a decision about what is the impact  
3 of whatever conduct we are worried about. Did it have a  
4 significant impact, and then, when we are proving in our  
5 case in court, it is a different exercise.

6 DR. CARLTON: Okay, who did I say? Mike?

7 DR. KATZ: You are not supposed to remind me of  
8 that. No, I would say a couple things. Part of it -- I  
9 will come back to what I said in my presentation,  
10 though, is that we can be using market definition in a  
11 number of different ways and that the level of -- we  
12 want to understand who the competitors are, because we  
13 want to figure out that is where we are going to see the  
14 competitive effects, are they harmed or not, does it  
15 matter if they are harmed, does it matter for  
16 competition and for consumer welfare. So, that level, I  
17 think we would certainly want to do market definition,  
18 but that may not be through a formal algorithm.

19 In terms of your question about the alternative  
20 prices, I think there is a difference between asking  
21 about a but-for price and asking about certain  
22 interpretations of the competitive benchmark, because  
23 you can take a competitive benchmark to be some formula  
24 based on marginal cost or average cost or something like  
25 that, and you could ask a market power question, but you



1 could well conclude from that that yes, this firm has  
2 market power, but it has not done anything wrong, okay?

3           It has market power because it has been a great  
4 innovator. So, I think that that is a different  
5 question than asking is it charging a higher price than  
6 the but-for price, because there you are asking about  
7 what would happen as a result of the specific piece of  
8 conduct. So, I think if one wants to go through the  
9 market definition exercise in that form and to have the  
10 competitive effects analysis be different than the  
11 market definition analysis, I think you can do it. One  
12 would ask about almost this more abstract or formulaic  
13 competitive price as the benchmark for market  
14 definition, and then the competitive effects analysis  
15 would look for a but-for price and would take into  
16 account a specific practice.

17           DR. CARLTON: I just don't know how to do the  
18 first in an analytic way that is other than comparing  
19 the two prices. If I cannot compare the two prices and  
20 I have to do a competitive effects, say an econometric  
21 analysis, I do not really need market definition. So,  
22 that is why I think what judges often do is, as Joe  
23 described, is do a seat-of-the-pants analysis or I  
24 described as a seat-of-the-pants analysis, but as Joe  
25 described, that is their screen.

1 DR. KATZ: Well, the screen makes sense if what  
2 the plaintiff is saying is there has been successful  
3 monopolization and you end up coming out of this being  
4 convinced that here is a sensible market definition that  
5 tells me how competition works, and this particular firm  
6 does not seem to be dominant in any sense or doing well,  
7 and if you see that, then it seems to me it does pretty  
8 heavily undermine the claim that there was successful  
9 monopolization.

10 DR. GILBERT: But that's Cellophane. I mean, it  
11 is Cellophane, did not look like they were --

12 DR. KATZ: No, Cellophane, they did not have the  
13 sensible market definition.

14 DR. GILBERT: Then you are back down to how do  
15 you define the market.

16 MR. SIMONS: Dennis, think about it this way:  
17 Someone had mentioned a gap earlier, and maybe it was  
18 Andy. If you think about under section 1, right, if you  
19 prove an effect, you win, right? Under section 2, the  
20 way you are describing the state of the law, which is  
21 accurate, is it is unilateral conduct. No contract.  
22 There may be an effect, and then liability is going to  
23 turn on whether there is some high market share.

24 DR. CARLTON: Right.

25 MR. SIMONS: So, the question to me would be,

1 why do you want to do that?

2 DR. CARLTON: I think that is right. Let me  
3 flip the question a bit.

4 It seems to me this emphasis on market  
5 definition in section 2 cases is coming precisely  
6 because of the way judges apply these screens and  
7 that -- I cannot remember -- I think Andy mentioned it,  
8 that just like you might want to have decision processes  
9 based on market shares, you might also want to immunize  
10 certain types of safe -- have safe harbors and as well  
11 as have danger zones, and it is the fact that it seems  
12 to me that the sequential decision-making in Section 2  
13 cases is first to look at market definition as a screen  
14 and then you go to competitive effects that causes this  
15 undue emphasis on market definition, and one way around  
16 that might be -- and this is going to be a question I  
17 will ask Andy and Phil -- suppose we also allow a screen  
18 based on safe harbors and said, "No section 2 cases if  
19 you're doing X, Y and Z; no section 2 cases if market  
20 share is -- you do not have market power."

21 Wouldn't that be a way to de-emphasize the role  
22 of market definition, which I think we are all agreeing  
23 is difficult to define in a section 2 case?

24 Let me first ask Phil, and then he --

25 MR. NELSON: Okay, wait a second, no market --

1 DR. CARLTON: Either you do not have market --  
2 the current screen, but I am going to add to that  
3 current screen that there are certain safe harbors, and  
4 what we should do is spend more time on defining the  
5 safe harbors for conduct rather than trying to figure  
6 out can we define markets any better.

7 MR. NELSON: So, it is conduct safe harbors,  
8 not --

9 DR. CARLTON: Correct, yes.

10 MR. NELSON: -- not structural safe harbors.

11 DR. CARLTON: Correct.

12 MR. NELSON: Okay, there was an "and" there, and  
13 I was starting to think that maybe where you wanted to  
14 go was a combination of a structural safe harbor with a  
15 conduct safe harbor, because there are certain types of  
16 conduct that might mean a lower market share, you could  
17 still have a problem, like some of these -- but I think  
18 there is a -- as I was alluding to, the importance of  
19 performance evidence, which is another way maybe of  
20 saying conduct, that you would want to start looking at  
21 some of that conduct evidence.

22 However, I am a little worried that the problem  
23 is that a lot of this conduct is not so easy to  
24 categorize, so that when you start to try to define a  
25 safe harbor using conduct evidence, I am not sure that

1 you are going to find a lot of situations where you can  
2 say for sure that this is conduct that is absolutely  
3 okay, because in other contexts, it may not be.

4 DR. CARLTON: I agree. Safe harbors make  
5 mistakes, but that is what decision theory tells us is  
6 the right thing to do.

7 Andy?

8 DR. GAVIL: I think the idea of defining safe  
9 harbors and danger zones, as I said, is useful, and I  
10 think you cannot do it just by using market share  
11 numbers, which has been our tendency in the past.

12 Now, once you use a market share number, you are  
13 stuck in the, "Okay, we need to define a relevant market  
14 problem." So, I think that reducing it to certain  
15 characteristics of the market, maybe it is structural  
16 characteristics, performance characteristics, but trying  
17 to look at other kinds of measures might make the safe  
18 harbor and the danger zones a little bit more meaningful  
19 and move the attention away from market share.

20 But one last comment, Joe said how this affects  
21 you in advising clients. That 70 percent share that has  
22 become pretty fixed for monopolization cases, that is  
23 perceived, even by defendants who do not like the market  
24 definition and market share approach analysis, that is  
25 perceived as a pretty big, significant safe harbor when

1 you are advising single-firm clients, and keep that in  
2 mind with all the monopolization cases.

3 If there really is not any good, strong argument  
4 that you could be in a market with a market share that  
5 is up in that range, you are pretty much free to do  
6 whatever you want. So, if we moved away from it, I  
7 suspect you would actually hear some objections from  
8 large firms that perceive that it is actually a very  
9 useful benchmark.

10 So, where I would come out is, I do not know  
11 that you can completely get away from the market shares,  
12 but maybe we need something like a market share plus,  
13 and not that it is a great model that we would ever want  
14 to rely on, but the concept from the Sentencing  
15 Guidelines that you have a guideline, but then you have  
16 factors that allow you to depart upward or downward, and  
17 that is sort of what Michael was talking about earlier  
18 when he was answering one of your questions, is certain  
19 factors might lead you to be cautious or less cautious  
20 in certain circumstances.

21 DR. CARLTON: Let's see, let me skip a few  
22 questions since I am going to try and end roughly on  
23 time or maybe at most five minutes late, but let me ask  
24 a question about technology, and I am going to direct  
25 this to Rich and Mike, because you have done a lot of

1 work in these areas.

2 It seems like a really hard question is where  
3 you have industries where marginal cost is low, product  
4 innovation is the key, and new products are coming out  
5 every so many years. It kind of came up a bit in the  
6 Microsoft case, and Dick will probably talk about this  
7 tomorrow, Schmalensee, but what do you mean by "market  
8 power" in those industries unless "durable" really means  
9 more than a year or two? Is that the right thing to be  
10 focusing on? If it is, if it is focused on in those  
11 industries, is it -- let me rephrase it. Is our focus  
12 on price misleading us and should we be focusing on  
13 other things?

14 DR. GILBERT: Well, I do not view that -- you  
15 have asked a lot of hard questions. I do not think this  
16 is one of the hardest questions. I find it relatively  
17 straightforward in the sense that when you are talking  
18 about dynamic competition, Schumpeterian spiral  
19 competition, it is very much like thinking about entry  
20 analysis. There is some probability that entry will  
21 occur at some date. The question is how soon will it  
22 be, what will be the magnitude of it.

23 There is also I think a legitimate question that  
24 even if entry is going to occur, is that going to  
25 neutralize the type of conduct we are concerned about,

1 or does the conduct we are concerned about promote entry  
2 or retard entry? It is my view that these are questions  
3 that can be addressed within the context of the way we  
4 do antitrust analysis generally.

5 Now, it is, of course, the case that in high  
6 technology industries, you are more likely to get very  
7 high price-cost margins, so you are more likely to be  
8 worried about market power, but it is often benevolent  
9 market power, and if it is benevolent, you should not be  
10 doing an antitrust case. So, it is more like magnifying  
11 the things that we are concerned about but not changing  
12 the qualitative way that in my view you should take them  
13 into account when you are doing an antitrust analysis.

14 DR. KATZ: I have a couple of things and maybe  
15 tie it to Microsoft. I mean, one of the things to  
16 remember is when the Government was looking at  
17 Microsoft, when the Government was dealing with them in  
18 the mid-nineties, everybody pointed out, "Well, look,  
19 it's such a fast changing market, and yes, it is true  
20 that Microsoft dominates personal computer software  
21 today and Apple is a distant second, and there are these  
22 other things that aficionados use, but they really have  
23 not caught on, and now here we are 12 years later and,  
24 okay, all of that's the same." So, this whole thing  
25 about the fast-paced -- and certainly Linux is doing



1 better than, you know, "the operating system" did, but  
2 sometimes we do tend to exaggerate the rate at which we  
3 think markets change and certainly relative to the pace  
4 of antitrust enforcement.

5 But the other thing is, I think, Microsoft I  
6 think is an interesting case, and maybe it comes back to  
7 one of Larry White's points, that the Microsoft case, I  
8 think it is fair to say that both sides took a  
9 Schumpeterian view. Microsoft said, "Look, this is  
10 Schumpeterian competition, someone else could come  
11 along, they will displace us, because of network  
12 effects, you would expect the winner to get a very high  
13 share in operating systems, and so leave us alone,  
14 because that's how competition occurs," and the  
15 Government said, "Okay, look, this is Schumpeterian  
16 competition. If you guys didn't do bad things --" Greg  
17 is shaking his head. Now, it is true, sometimes the  
18 Government didn't say that, but I think the only  
19 sensible interpretation of what the Government was  
20 saying was, "This is a Schumpeterian market, and,  
21 Microsoft, you are trying to stop the next wave of  
22 innovation that would have displaced you," and I am  
23 saying that's somewhat like Larry's point about saying  
24 it is not just how well you are doing in some absolute  
25 sense, but whether there is a threat that you are trying

1 to stop that would leave you worse off.

2 So, I mean, I think in that one is the  
3 Schumpeterian view was consistent with saying we have to  
4 intervene, although it does shift what you look at.

5 DR. CARLTON: All right. Well, we are about out  
6 of time, so I want to end with this, to get everybody to  
7 comment on this question.

8 In light of all the difficulties and ambiguities  
9 with the use of market definition in section 2 cases, is  
10 it your view that we should still rely on it as we do,  
11 put less reliance on it, or go to a competitive effects  
12 and forget about market definition? So, why don't we  
13 just go down the table in order.

14 MR. NELSON: Okay, I think I am halfway between  
15 your two extremes, because I think there are -- as I say  
16 in my slides, I think that there are organizing  
17 principles and things that the exercise -- the market  
18 definition exercise helps you understand what is going  
19 on and tell either a story or an analysis that is  
20 internally consistent, but that is not to say you have  
21 to do it in every case, and there are numerous cases  
22 where you may be able to expedite things by going  
23 straight to the competitive effects bottom line.

24 MR. SIMONS: My take would be that the DOJ and  
25 the FTC should try to come up with something that

1 focuses only on competitive effects, does not worry  
2 about market share, and then see what happens over time  
3 in terms of what they come up with and how operable it  
4 is. And if the thing really works, terrific, then try  
5 to get it into the courts, but not worry about that at  
6 the outset.

7 DR. WHITE: Yes, we ought to be looking -- I  
8 have a feeling we are going to be having all of the  
9 divergence of opinion ranging from A to B. Yes, you  
10 ought to look at competitive effects more than we have,  
11 but I think there is still going to be a role for market  
12 definition. Think about the private suits, not the  
13 government suits, but the private suits that were  
14 brought against MasterCard and Visa, and these were --  
15 you know, the -- say take a WalMart case. This was a  
16 tying case, but they were not -- it was -- you could  
17 tell some stories about how if the tie was not there,  
18 there were -- there would have been more entry somewhere  
19 in -- in the credit card markets, but it was primarily  
20 the tie is preventing us merchants from doing something  
21 we would like to do.

22 I am not sure a competitive effects analysis is  
23 going to tell you about market definition in that  
24 particular case. Of course, MasterCard and Visa were  
25 telling you, oh, all kinds of transaction media are in

1 the market, you know, cash and checks and everything, we  
2 do not have market power, and they were actually trying  
3 to say it with a straight face.

4 A market definition paradigm I think would help  
5 in that kind of case, and so yes, I think we still have  
6 need. I am hoping this is 1981, and next year, some  
7 smart people are going to come in with a useful  
8 paradigm.

9 DR. CARLTON: Andy?

10 DR. GAVIL: I think I agree with Larry. I think  
11 it still has a role to play, but I think as you stated,  
12 I think I would agree also that we over-rely on it, and  
13 I think somewhat complex is the problem of  
14 over-reliance. I think it can lead to both false  
15 positives and false negatives, but I think with the  
16 false positives, if somebody is found to have monopoly  
17 power, to some degree, you have the backstop of the  
18 conduct inquiry.

19 My concern is because of the high process costs  
20 in trying to prove monopoly power in this -- as you  
21 described it accurately -- sequential model, you get  
22 false negatives, and there is no backstop to that. The  
23 case ends, and the court does not look at conduct, does  
24 not look at effects. So, I think this is an example  
25 where the over-reliance may actually increase the threat

1 of false negatives more so than false positives.

2 DR. GILBERT: I would join the chorus that we  
3 need more emphasis on competitive effects. A good  
4 example, not necessarily really in the section 2  
5 context, is the Oracle merger case where in my view  
6 there was some certainly interesting evidence, if not  
7 dispositive evidence, about competitive effects, but  
8 once Judge Walker determined that he could not define a  
9 market, he then concluded that there was no market, and  
10 the competitive effects were almost ignored in that  
11 case, and to me, it is like saying that I do not know  
12 exactly where downtown Los Angeles is, and therefore,  
13 there is not one. But I also can sympathize that if we  
14 did away with market definition completely, it could be  
15 highly problematic in leading to a lot of cases.

16 DR. KATZ: Okay, well, I guess I will say, at  
17 the risk of sounding like Bill Clinton, it depends on  
18 what one means by doing market definition, and I think a  
19 lot of times what people mean is they mean applying the  
20 hypothetical monopolist test, they mean doing a  
21 concentration analysis, and they mean trying to come up  
22 with boundaries with certainty, and then slavishly  
23 applying that, and if you cannot meet that, you throw  
24 the case out.

25 I think that way of doing things is surely

1 wrong, but I think we also surely do want to do some  
2 sort of market definition exercise in the sense of  
3 identifying the competitors, and I think where we have  
4 come up short is what is the right way to do it in the  
5 middle in terms of I think we still do not have a very  
6 good sense of what is the right algorithm and the right  
7 approach in different situations.

8           We have not mapped out, so, here is exactly  
9 where you could do the hypothetical monopolist test,  
10 here is where we need to do some alternative  
11 methodology. We do not have that, and I think the  
12 courts -- sometimes, the fact that we do not have that  
13 has become an obstacle to good decision-making, as Rich  
14 was just saying in the Oracle case, but I think the  
15 bottom line is we need to figure out a better way to do  
16 market definition, and that way we will recognize that  
17 it should not be taken overly seriously or applied too  
18 mechanically.

19           DR. CARLTON: Thank you very much. I want to  
20 thank the people at the Department of Justice and the  
21 FTC who did all of the legwork in putting this together,  
22 and I am sure, although I have not checked with them,  
23 all of the panelists, myself included, thank Larry White  
24 for not including us in his slide of dumb quotes, and I  
25 want to personally thank everybody on the panel for

1 coming and giving us the benefit of their substantial  
2 expertise. I have learned a lot, and I thank you all.

3 (Applause.)

4 (Whereupon, at 12:36 p.m., a lunch recess was  
5 taken.)

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## 1 AFTERNOON SESSION

2 (2:01 p.m.)

3 MR. WALES: Well, good afternoon, everybody.  
4 Thanks so much for braving the cold and the snow. I  
5 think we have a very exciting panel on tap for this  
6 afternoon. For those of you who were here for this  
7 morning, I hear it was very lively, and I am hoping that  
8 we can live up to that and be lively as well.

9 My name is Dave Wales. I am a Deputy Director  
10 here in the Bureau of Competition at the Federal Trade  
11 Commission. I will be moderating today, along with Greg  
12 Werden, the panel. Greg is the Policy Project Director  
13 At the Economic Analysis Group at the Antitrust Division  
14 of the Department of Justice. That is his official  
15 title, and you will be hearing more from him shortly.

16 Have you been elevated perhaps?

17 DR. WERDEN: I have never even heard of that  
18 title.

19 MR. WALES: Is it better than the one you have?

20 DR. WERDEN: No, not really.

21 MR. WALES: Not really? Sorry about that, Greg.

22 Before we get into substance, it is my job to do  
23 a little bit of the housekeeping. First off, what I  
24 would like to do is on behalf of the FTC, to really  
25 thank our friends at DOJ in putting this together, and I



1 think it has been phenomenal to date, and I am sure it  
2 will continue to be that way. I would also like to  
3 thank each of our five panelists today for, again,  
4 braving the weather and coming out, and I think we have  
5 got some great issues to discuss.

6 Today and tomorrow, I guess today and tomorrow,  
7 we have the hearings on monopoly power, and I guess what  
8 I wanted to point out is that next month we will be  
9 turning to the issue of remedies, which should also be  
10 pretty interesting. Stay tuned for that. I guess what  
11 we typically do is post the schedule on each agency's  
12 web page, so look out for those.

13 A couple housekeeping items. First, I guess we  
14 ask that people turn off their cell phones,  
15 BlackBerries, any other electronic devices that make  
16 annoying noises. Second, importantly, restrooms are out  
17 across the lobby. In case someone needs to use those,  
18 follow the signs, you cannot miss them.

19 Third, a safety tip for everybody, I guess in  
20 the event the fire alarms do go off, please do not  
21 panic. Please walk towards the exit, and we will guide  
22 you to I guess a safe place across the street where we  
23 will gather, hopefully with warmer coats.

24 Lastly, I guess the way we set this up is we ask  
25 that the audience please not ask questions, and we are

1 going to have a lively discussion today, so you can look  
2 forward to that.

3 Many of the prior sessions talked about  
4 obviously the conduct involved in section 2 challenges,  
5 and today, what we would like to talk about is a  
6 separate topic, which is, of course, monopoly power and  
7 defining markets when monopoly power has been alleged,  
8 and I think that is a pretty important topic, one that I  
9 think when the hearings kicked off, that Herb Hovenkamp  
10 and Dennis Carlton identified as being one of the two  
11 that they thought were probably the toughest and two  
12 that needed a lot of discussion. So, hopefully we will  
13 be able to accomplish that today.

14 I think that is pretty much what I wanted to  
15 say, Greg. I don't know, maybe you want to give your  
16 title and anything else you want to say.

17 DR. WERDEN: Yes. Hi, I am Greg Werden, Senior  
18 Economic Counsel in the Antitrust Division, Department  
19 of Justice. I just want to add my thanks to our  
20 panelists and the staffs of the two agencies for  
21 organizing this session.

22 MR. WALES: Great, thanks.

23 The way the format is going to work today is  
24 similar to what we have done previously and did this  
25 morning. First, we are going to have each presenter

1 give about a 15 to 20-minute oral presentation, and then  
2 what we will probably do is take a break either in the  
3 middle of that or towards the end of that, we will see  
4 how long things go, after which we are going to have a  
5 moderated discussion where we will give each panelist an  
6 opportunity to respond to the other panelists and also  
7 for Greg and I to pose some questions and some  
8 principles that we think we might be able to move  
9 towards convergence on.

10 With that, I guess what I would like to do is  
11 introduce Simon, our first speaker. Simon is a partner  
12 and co-founder of RBB Economics. He has been advising  
13 clients on competition policy issues since 1991 and has  
14 particular expertise in applying empirical techniques in  
15 the context of merger investigations. In addition to  
16 his private sector work, Simon has been seconded for a  
17 short period of time to the German Federal Cartel  
18 Office, where he gave a series of seminars on use of  
19 economics in competition law. Simon has published  
20 widely on virtually all aspects of competition law  
21 economics and is a regular speaker at competition law  
22 conferences. He is a co-author of The Economics of EC  
23 Competition Law and has worked on several hundred  
24 competition law matters spanning virtually all sectors  
25 of the economy. Thanks, Simon.

1           MR. BISHOP: Long intro, and you forgot to say I  
2 am from Europe. I am up first, and given that it was  
3 probably a lively session this morning, I think probably  
4 the reason I have been chosen to go first is because my  
5 topic this afternoon is probably the driest and most  
6 technical, which is my remarks are really going to  
7 concern the Cellophane fallacy and what implications  
8 that has for a structural approach to assessing  
9 monopolization or what we Europeans talk about as an  
10 abuse of dominant position.

11           I am also going to say that my remarks are also  
12 sort of Euro-centric in the sense of this really  
13 reflects my experience of EU cases and European national  
14 competition law cases and not really the U.S. case law;  
15 however, given that we are all in this facade, one might  
16 say, or claims that there is increasing convergence  
17 between Europe and the U.S., I hope that some of these  
18 remarks will actually carry over to U.S. antitrust.

19           Now, in order to give this some sort of context,  
20 in Europe, as in the U.S., we are engaged in an ongoing  
21 reform of Article 82, which is the equivalent of the  
22 monopolization act, and last year, the European  
23 Commission, of which Miguel was heavily involved, issued  
24 guidelines on how to reform Article 82 and to move the  
25 current system away from a form-based approach to a much

1 more effects-based approach.

2 Now, that is all very admirable, but it seems to  
3 me that within these guidelines of reform, there is the  
4 elephant in the room which no one really wants to talk  
5 about; namely, the concept of dominance. Really,  
6 dominance is also based on structural market share. In  
7 Europe, we have the two-step process, whether a firm is  
8 found to be dominant and then whether, if that firm is  
9 found to be dominant, whether that behavior constitutes  
10 an abuse of a dominant position.

11 Now, as I said, all the focus has been on the  
12 second step, but the problem is is that within Europe,  
13 certainly how the courts have interpreted dominance and,  
14 indeed, some of Miguel's colleagues in the Commission  
15 also, is that if you are dominant, then any behavior  
16 which affects or harms competitors is almost deemed to  
17 necessarily harm competition, and if you take that  
18 approach, then that really means there is no role for an  
19 effects-based analysis within European antitrust under  
20 Article 82.

21 It also means that the dominance, and therefore  
22 the market share calculations and market definition, are  
23 absolutely paramount in the whole assessment. Now, we  
24 all know that from the sort of 1982 U.S. Merger  
25 Guidelines, there has been pretty wide acceptance that

1 the hypothetical monopolist test or the SSNIP test has  
2 provided the appropriate framework for assessing and  
3 defining relevant markets. We also know that, even  
4 though we have the framework and that is well accepted,  
5 in actual individual cases, it is actually quite hard  
6 sometimes to actually implement that test. Actually, in  
7 monopolization cases or abuse of dominance cases, things  
8 are even more difficult because of the existence of the  
9 Cellophane fallacy.

10 Now, what is the Cellophane fallacy? What are  
11 the problems? Well, in a merger context, which is where  
12 the SSNIP test or hypothetical monopolist test was first  
13 proposed, we are interested in what has the merger  
14 changed? Is it going to relax competitive constraints  
15 at prevailing price levels? Now, that has an important  
16 implication, because that says we can use existing data,  
17 observed data, to assess the strength of existing  
18 competitive constraints between products supplied by the  
19 merging parties.

20 However, when we talk about monopolization  
21 cases, in many cases -- and some might argue in all --  
22 the relevant issue is not whether the prices can go up  
23 even further from prevailing levels, but actually, have  
24 prices already been increased above competitive levels?  
25 Now, the important implication of that is that using

1 observed data will tend to overstate the competitive  
2 constraint, because as we know from the famous DuPont  
3 Cellophane case, is that even a monopolist, if you put  
4 up prices far enough, something is going to start  
5 looking like an effective substitute at some point,  
6 because even monopolists face some constraint. So, the  
7 real issue here I think from the Cellophane fallacy is  
8 what implications does it have for the use of empirical  
9 analysis?

10 Now, that is a case of sort of, well, what do we  
11 do about this? We know that the Cellophane fallacy  
12 exists, and we know that that has a big impact on how we  
13 can interpret and use existing data. Well, there are a  
14 number of approaches which have been put forward to try  
15 and address the Cellophane fallacy. One which has been  
16 put forward in a number of cases both by the European  
17 Commission and some national competition authorities in  
18 Europe is to say, "Well, the hypothetical monopolist  
19 test is only one way of defining a relevant market."

20 Well, the question or the problem with that sort  
21 of line of argument is, they do not actually tell you  
22 what the alternative ways of defining a relevant market  
23 are, and what is good about the hypothetical monopolist  
24 test is it is forcing people to at least think about the  
25 scope for demand-side substitution and supply-side

1 substitution, and if those two things are not part of  
2 the approach of defining a relevant market, it seems to  
3 me that, indeed, any other alternative approach is  
4 useless for antitrust purposes.

5           The second approach to trying to deal with the  
6 Cellophane fallacy is, "Well, let's just recalculate  
7 everything from the competitive price." Well, great  
8 idea, but if we knew what the competitive price is, then  
9 we would not need to be defining what the relevant  
10 market is. We could just say, "Well, we observed that  
11 Firm X is charging 10, we know the competitive price is  
12 5; therefore, there must be some sort of exercise of  
13 market power going on." But that is not how the real  
14 world works.

15           So, as a slight anecdote here, I was reading in  
16 some of the trial transcripts in the Microsoft case, one  
17 of the economists I think it was for the DOJ was asked,  
18 "Well, what is the competitive price that Microsoft  
19 should charge?" The answer was, "Lower than they  
20 currently charge," which seems to me sort of just  
21 demonstrate the difficulties of actually re-adjusting  
22 what the competitive price is. So, that is not going to  
23 get us anywhere.

24           The third approach is, "Well, let's just ignore  
25 the Cellophane fallacy; pretend it does not happen."



1 Well, again, that is not going to work, because if you  
2 ignore it and just apply empirical analysis, you are  
3 going to tend to define relevant markets too widely, and  
4 therefore, not capture some market power when we should  
5 be capturing it.

6           The fourth approach which has been proposed,  
7 which is, "Well, let's do away with market definition  
8 altogether. It is difficult -- we have got the  
9 Cellophane fallacy, you know, we are very smart economic  
10 professors or consultants, and we can just sort out --  
11 you know, market definition is just an interim step. We  
12 can go straight to the answer." Well, personally, I am  
13 a bit more humble than that, and I think if we see the  
14 relevant market definition and the structural analysis  
15 for what it is, i.e., an intermediate step, I think it  
16 is important that we keep that step.

17           Secondly, if you do away with it, it actually  
18 introduces real scope for ad hoc analysis. There is a  
19 real -- we know that particularly in the areas of  
20 exclusionary abuses or exclusionary power, trying to  
21 discriminate between behavior which just merely harms  
22 competitors and is therefore procompetitive from that  
23 which harms competitors and drives them out of the  
24 market and leads to harm to consumers is very, very  
25 difficult, and really, the market definition structural

1 screen provides a good touchstone to prevent people from  
2 adopting "I know abusive behavior when I see it."

3 So, I think that sort of a summary of this is  
4 really we are stuck with the hypothetical monopolist  
5 test, the SSNIP test, as a framework for thinking about  
6 how we define relevant markets, and we are also stuck  
7 with the Cellophane fallacy. We need to accept that it  
8 exists. So, what are my proposed implications for the  
9 sort of policy?

10 Well, a structural analysis still can provide a  
11 very useful filter, and even recognizing the existence  
12 of the Cellophane fallacy, I think we can go through a  
13 number of steps, that we can define relevant markets  
14 which are consistent with the basic principles of the  
15 hypothetical monopolist test. So, if someone proposes a  
16 relevant market and that it does not seem to be  
17 consistent with the principles of demand-side  
18 substitution or supply-side substitution, then it is not  
19 a relevant market. So, I think even just using the  
20 SSNIP test as a thought process can actually provide a  
21 useful discipline on how to define relevant markets.

22 Secondly, we know the Cellophane fallacy exists,  
23 but if the parties are arguing for a wide market  
24 definition, then they at least ought to be able to  
25 demonstrate that at prevailing prices, there is

1 substitution. Now, that means that it does not stop  
2 with saying, "Well, the price has already been increased  
3 above competitive levels and is subject to the  
4 Cellophane fallacy," but at least they should be able to  
5 show that at prevailing prices, there is a competitive  
6 constraint between product A and product B if they are  
7 arguing they are in the same relevant market.

8           The third element I think is we can look at  
9 product characteristics in the marketplace, but again, I  
10 think we should be careful about how we look at that,  
11 and this really goes back to my first point, which is  
12 consistency with basic principles, is it is not saying  
13 that these two products are not in the same relevant  
14 market because they look different or have different  
15 product characteristics. We are saying they are not in  
16 the same relevant market because the differences in  
17 product characteristics imply that demand-side  
18 substitution or supply-side substitution is unlikely.

19           The fourth element is that there are some cases  
20 and there is some evidence which is not subject to the  
21 Cellophane fallacy which we can use to discriminate  
22 between competing claims, and as always, there is a  
23 paper by Greg Werden, who addresses this, and I think it  
24 was from about 2000.

25           The second policy issue is, well, we have

1 defined the relevant market, we have calculated some  
2 market shares, and clearly we need to put that into  
3 context. We need to take into account the scope of all  
4 barriers for entry, expansion, the scope of buyer power,  
5 whether the market is subject to bidding competition,  
6 and also general market dynamics.

7 My final comment was really, well, let's be  
8 humble here, because we can go through all of these  
9 steps, but in a lot of cases, the available evidence  
10 will not allow us to discriminate between the wide  
11 market definition which the parties are putting forward  
12 and the narrow market definition which the agencies are  
13 going to be putting forward. Everything may be  
14 consistent with the basic principles of the hypothetical  
15 monopolist test, the parties can show that at prevailing  
16 prices there is substitution and so on and so on, and  
17 where you have got these two competing potential market  
18 definitions, sometimes that will not be a problem,  
19 because the market shares in both of those may be low,  
20 and then unlikely to have market power. Alternatively,  
21 market shares in both of those could be high, and then  
22 that is not really a problem, because the market power  
23 is reasonably high. The difficulty or the problem,  
24 potential problem, is where in one market, the narrow  
25 market, the firm has a high market share, and in the

1 wide market, it has a low.

2           It seems to me when you are in those situations,  
3 all it says is, well, then we really need to have some  
4 pretty good evidence and examination of the business  
5 conduct, and this I think brings me back to where we are  
6 in Europe, is that a lot of times in Europe, with the  
7 current situation, the business conduct is not assessed  
8 on the market effects, but actually on the form of the  
9 business conduct. So, the reform in Europe is certainly  
10 going in the right direction in focusing on the form,  
11 and that is the end of my comments.

12           Thank you.

13           MR. WALES: Thanks very much, Simon.

14           (Applause.)

15           MR. WALES: Our second speaker is Miguel de la  
16 Mano. Miguel joined the European Commission in 2001 and  
17 is currently a member of the Chief Competition  
18 Economist's Team. He carries out economic analysis in  
19 mergers and commercial practices by dominant companies  
20 and their impact on the competitive structure of the  
21 markets. He is also responsible for drafting  
22 guidelines, setting the Commission's analytical  
23 framework in these areas, a key area. He completed  
24 graduate studies in economics at The Institute For the  
25 World Economics in Kiel, Germany and The European

1 Institute at Saarbrucken University, Germany. He  
2 conducted his Ph.D. research at Oxford.

3 With that, Miguel? Thanks.

4 MR. de la MANO: Thank you very much. It is  
5 definitely a pleasure and also a great honor to  
6 participate on this panel today together with so many  
7 distinguished and well-experienced practitioners.

8 I will try to contribute to this issue basically  
9 by offering a view or an assessment of the way in which  
10 dominance or the role that dominance plays today in  
11 competition policy assessment in Europe and which, as  
12 you know, is enshrined in Article 82, which is the  
13 equivalent of section 2 here in the U.S.

14 As you also know and as Simon has remarked, the  
15 Commission is in the process of reviewing its policy in  
16 the area of Article 82, and like every type of reform,  
17 it is somewhat case-dependent, and we are constrained by  
18 case law and case practice; however, we believe that the  
19 time is right basically to align the implementation or  
20 the enforcement of Article 82 to current thinking and  
21 current economic knowledge, and, of course, to a more  
22 modern analytical framework.

23 So, I will basically start by making a somewhat  
24 obvious remark, yet actually crucial, which is that in  
25 the context of the analysis of monopolization in Europe,

1 dominance is a necessary condition. That is how the  
2 system has been set up, and the EU Treaty actually  
3 prohibits single-firm conduct that harms consumers only  
4 when undertaken by a dominant company, and normally, to  
5 ensure the efficiency of the decision-making process,  
6 this also means that the first step of the analysis is  
7 to establish whether or not a single firm actually is in  
8 a dominant position or not. It is not a must, but that  
9 is just the best way forward. If a single firm is not  
10 dominant, then there is no need to proceed any further.

11 At the same time, a somewhat more subtle point,  
12 this also rules out what in the U.S. is attempted  
13 monopolization. If you are not dominant in the first  
14 place in the EU, basically there is nothing you can do  
15 that will violate Article 82, and I think this is an  
16 important point, because it somewhat dispels the myth  
17 that in the EU, there is a serious concern or serious  
18 worry with type II errors; namely, false acquittals. I  
19 think personally that is not the case.

20 But what are the reasons for this institutional  
21 setup? I can think basically of two primary reasons.  
22 Number one is to provide legal certainty. Surely it is  
23 better for firms to know in what circumstances they may  
24 be liable to and they are obligated to. There is also  
25 another reason, which is that we should not forget, it

1 was member states that have delegated the powers to a  
2 rather independent body, namely the European Commission,  
3 to enforce competition policy in their name, and when  
4 delegating such powers, member states want some  
5 assurances that these powers will not be abused, and  
6 therefore, forcing the Commission to start off by  
7 assessing whether or not a firm is dominant imposes some  
8 sort of discipline, which understandably was necessary  
9 for member states to delegate such powers.

10           However, unfortunately, despite the best wishes  
11 of everybody at the time, maybe 30 years ago, it has not  
12 fully worked, and I think there are three reasons why it  
13 has not fully worked, which I would like to share with  
14 you and hopefully also in doing so contribute to the  
15 thinking that is taking place here in the U.S. with  
16 respect to monopolization.

17           The first reason why they do not work is the  
18 concept of dominance is somewhat elusive. The member  
19 states put it into Article 82; however, no definition  
20 was actually provided. That was left for the courts to  
21 develop one over time.

22           However, as is normal, the courts were actually  
23 reacting to cases that were brought to them, and they  
24 were not necessarily thinking in the abstract, well,  
25 what is it that dominance should mean? How should it be



1 defined? But instead, we are reacting to the  
2 circumstances.

3 Of course, it became increasingly complex and  
4 increasingly difficult to understand exactly what  
5 dominance is as time went by and European courts were  
6 issuing rulings where the concept of dominance was  
7 mentioned or in some cases defined.

8 Of course, what happened ultimately is that,  
9 before the Commission, it became increasing difficult to  
10 identify what is dominance, and therefore, the more  
11 difficult it was, the more elements which would normally  
12 go into the competitive assessment crept into the  
13 assessment of dominance, up to a point where it seems,  
14 at least to me, that as Simon pointed out before,  
15 assessing dominance became an end in itself to the  
16 extent that once dominance had been established, it was  
17 not just a necessary condition but almost sufficient for  
18 a finding of abuse.

19 Now, I think that these three concerns can be  
20 corrected, and this is, of course, the rationale for the  
21 review process, and I would just like to share with you  
22 the three ways in which I think this can be done.

23 So, first of all, again, a rather obvious  
24 statement, but somewhat important in a context where  
25 European courts have said that the dominant firms have a

1 special responsibility, whatever that might mean,  
2 dominance should be defined or equated with substantial  
3 market power. Now, of course, all firms have some  
4 market power, but most of them have very little, and  
5 accordingly, the relevant question in antitrust cases  
6 should not be whether market power is present or not --  
7 it always is -- but whether it is important, that is,  
8 whether it is substantial.

9 In going back to the sort of most established  
10 definition of dominance by the ECJ, dominance is said to  
11 be a situation where a company has the power to behave  
12 to an appreciable extent independently of its  
13 competitors, customers and ultimately its consumers, and  
14 a close look at this definition suggests, indeed, that  
15 dominance can be equated to significant market power,  
16 and this is because a firm is dominant if its decisions  
17 are fairly insensitive to reactions of competitors and  
18 customers. That is what the "to an appreciable extent"  
19 actually means. Of course, no firm is fully independent  
20 of customers and competitors, that we know from economic  
21 theory, but to an appreciable extent, it might well be.

22 The measure of this sensitivity, of the  
23 sensitivity to the actions of others, is given by an  
24 elasticity, which is, again, the other side of the way  
25 that economists would measure market power in practice.

1 So, we end up with a situation where to behave  
2 independently to an appreciable extent can be definitely  
3 equated to an ability to significantly and profitably  
4 durably increase prices, and therefore, there should be  
5 no more debate about what is dominance, just substantial  
6 market power.

7 Now, how is this substantial market power to be  
8 established? Well, again, this is not new to anyone,  
9 but I would argue that first market shares have to be  
10 significant, and significant in two senses. First, they  
11 have to be significant in that they must be important,  
12 high, but also significant in that they are actually  
13 providing a good proxy for the relative insensitivity of  
14 the single firm to the actions and reactions of its  
15 competitors and customers. There is, again, a good  
16 paper by Greg Werden which talks about assigning market  
17 share and how difficult this process actually is.

18 The second point is that barriers to entry and  
19 expansion have to be significant, and by this I would  
20 like to emphasize that we mean in the absence of the  
21 conduct, not barriers to entry in general, but in the  
22 absence of the conduct, if the conduct itself actually  
23 increases barriers to entry or barriers to expansion.  
24 Now, that is part of the anticompetitive effects of such  
25 conduct, and therefore, it should not be seen as an

1 element that plays a role in establishing dominance.

2 Of course, there are other elements like  
3 dynamics of the market, there should be no technological  
4 leapfrogging, and buyer power, it cannot be shown that  
5 the customers have very little countervailing buyer  
6 power.

7 Now, I will try to make here a rather  
8 provocative statement, but in my view, the acid test,  
9 the way to ensure whether a company is dominant or not,  
10 is to ask, well, is it the most efficient in the market?  
11 Because if it is, it is likely to have high market  
12 shares, it is likely to be very difficult to enter  
13 successfully and profitably, and it is also going to be  
14 very difficult possibly to leapfrog.

15 However, one might argue, well, isn't this just  
16 the old efficiency offense? Well, I do not think this  
17 is an offense, because I personally think there is  
18 nothing wrong with being dominant. There is no offense  
19 in being dominant, and companies should not feel that an  
20 assessment of dominance actually implies that this is  
21 going to lead to a finding of anticompetitive behavior  
22 on their part. Quite the opposite, a finding of  
23 dominance should in most cases just mean that they are  
24 probably the most efficient company out there.

25 This takes me to the final point, which is that

1 dominance is not only a screen. It is not an end in  
2 itself. It is just a screen to try and filter out, as  
3 Simon was saying, those situations where there might be  
4 scope for significant harm to consumers resulting from  
5 certain conduct from other situations where this is very  
6 unlikely to happen.

7 Now, it is clear that if a practice is shown to  
8 be anticompetitive, the firm must be dominant, but  
9 proving that a practice is anticompetitive is hard, and  
10 it takes a lot of time and resources. Therefore, it  
11 seems like assessing dominance can play a very important  
12 role in acting as a screen, and it is also a screen that  
13 bites. It bites because large firms may not necessarily  
14 be dominant if innovation is taking place at a rapid  
15 place, if there is fierce competition between large  
16 players, for instance, in the concept of bidding  
17 markets, or if there is strong disciplining by potential  
18 entrants or customers.

19 Now, I am just going to briefly go into a  
20 non-hypothetical example, which unfortunately I am not  
21 allowed to get into further details of the market, but  
22 where actually I will be able to show to you that the  
23 Commission takes very seriously the dominance screen and  
24 it actually works in practice.

25 We had a case not long ago where the defendant

1 had very high market shares in a homogenous good market,  
2 above 60 percent. There were very important and  
3 significant barriers to entry, like large overcapacity  
4 on the part of the dominant company, declining demand,  
5 high fixed costs to establish new facilities, but also  
6 strong learning effects in the process. It was common  
7 practice in the industry to use very long-term  
8 contracts, which, of course, we argued would limit  
9 customer switching, and not the least of which the  
10 defendant seemed to be in a very strong position to fend  
11 entry given that it had the broadest product range and  
12 the largest financial resources. So, with this criteria  
13 on the table, one would very easily conclude that this  
14 company is actually dominant.

15 Well, actually, the Commission concluded it was  
16 not, and this was on five counts. First, there was  
17 significant buyer concentration. The top three  
18 customers took 70 percent of the market. There was  
19 product homogeneity, which allowed them to switch  
20 suppliers without incurring significant switching costs,  
21 and buyers, indeed, have dual sourcing strategy to shift  
22 volumes between suppliers with little transaction costs.  
23 Rival suppliers had significant overcapacity which they  
24 could use to expand, and therefore, there were no  
25 barriers to expansion. It was also found that the

1 competition mechanism was bidding for large and very  
2 occasional contracts, just every few years.

3 So, I would just like to conclude with two  
4 remarks, one on market shares and one on market  
5 definition, linking it to what Simon has said. First,  
6 on market shares, it is, often said that there should be  
7 a bright line safe harbor, and also that, only firms who  
8 are market leaders can ever be dominant. I think the  
9 latter makes no economic sense, and this is clear given  
10 the application of unilateral effects in the area of  
11 merger control, and, of course, at least in the context  
12 of European competition policy, the dominance concept  
13 plays a role both in mergers and antitrust, so they are  
14 interlinked.

15 However, bright line safe harbors do make sense;  
16 however, I believe the threshold should be set rather  
17 low, and this is for four reasons. First of all, rivals  
18 might be constrained. For example, in the electricity  
19 industry, this happens very often. You might have  
20 strong multi-market presence, like in the airline  
21 industry, if you have one company who is number two in a  
22 number of routes and the number one company in each one  
23 of the routes is a different one, one can argue that  
24 this company who was number two everywhere is actually  
25 more dominant or has more significant market power given

1 this multi-market context than anyone who just has a  
2 leadership position in one individual route.

3 Market leaders are more constrained by  
4 regulation than nonleaders, and that can be the case in  
5 certain industries, such as telecoms, and the leader may  
6 be more constrained by close substitutes or by new  
7 entry, for example, in the case of pharma. There was a  
8 case of AstraZeneca in the EU not long ago where this  
9 was clearly an issue.

10 So, what are the policy implications for not  
11 arguing that only if you are the market leader, you can  
12 be dominant? There are at least two. One is that for  
13 consistency, I will just mention unilateral effects in  
14 mergers, but also, to leave the door slightly open for  
15 attempted monopolization in the EU, in the EU policy.

16 Then just one very short and final remark on  
17 market delineation, which I will just start by saying  
18 that I agree with everything that Simon has said, but  
19 unfortunately, even though I think we ought to be humble  
20 and I definitely agree with that, the EU Commission is  
21 forced to be arrogant, because in a sense, we are  
22 obliged to take decisions. We have to say what we think  
23 about the market. We cannot leave definitions open. We  
24 have to say whether we think it is narrow or we think it  
25 is wide, whether or not we win the case, and this is a



1 problem.

2           This is a problem because we cannot just say,  
3 well, you know, let's ignore the Cellophane fallacy or  
4 let's think about the Cellophane fallacy as something  
5 that plays a very significant role and there is nothing  
6 we can do about it, so we just be humble. That we  
7 cannot afford to do.

8           However, I think we do not have to lose all  
9 hope, because when thinking about the role or the  
10 assessment that dominance plays, particularly thinking  
11 of dominance as a screen, I think that even if we  
12 recognize that the hypothetical monopoly test, the SSNIP  
13 test, is, indeed, a useful conceptual framework to  
14 identify competitors that are constraining a single  
15 firm, the assessment of dominance actually goes a step  
16 further, and not just ask the question, well, which are  
17 the firms that are there constraining the incumbent, but  
18 actually asking, well, how much are they constraining  
19 the incumbent?

20           So, in trying to figure out how much is the  
21 incumbent being constrained or the defendant being  
22 constrained, we can also have a good glimpse into which  
23 other firms that are part of that particular market, and  
24 therefore, market delineation can in some cases -- not  
25 always, but in some cases -- be a by-product of the

1 dominance assessment, and this obviously simply reflects  
2 that market definition is a means to an end, and what  
3 the real issue is is market power.

4 Thank you very much for your attention.

5 (Applause.)

6 MR. WALES: Thank you, Miguel.

7 Next up we have Tom Krattenmaker. Dean  
8 Krattenmaker is currently Of Counsel in the Washington,  
9 D.C. office of Wilson Sonsini Goodrich & Rosati, where  
10 he focuses on antitrust, telecommunications and trade  
11 regulation issues. Immediately prior to joining Wilson  
12 Sonsini, Tom was an attorney in the Federal Trade  
13 Commission's Bureau of Competition, Office of Policy and  
14 Coordination, where I had the pleasure of working with  
15 him for too short a time, but really enjoyed my time  
16 working with him. In that role he principally served as  
17 legal adviser to the bureau directors and to attorneys  
18 investigating and litigating antitrust cases and advised  
19 on several Bureau and Commission public reports.  
20 Previously he served as senior counsel in the Department  
21 of Justice's Antitrust Division and held positions at  
22 the Federal Communications Commission, including Chief  
23 of Telecommunications Merger Review and Director of  
24 Research and Co-Director of the Network Inquiry Special  
25 Staff. Tom has spent more than 30 years in legal

1 education. He was a Professor at the University of  
2 Connecticut, Professor and Associate Dean at Georgetown  
3 University and the Dean of William & Mary School of Law.

4 Thanks, Tom.

5 MR. KRATTENMAKER: Hello. I'd like to begin by  
6 thanking Dave and Greg for giving me this monopoly  
7 platform for 15 or 20 minutes and am particularly  
8 appreciative for you surrounding the platform with the  
9 entry barriers with your declaration that there be no  
10 questions from the audience.

11 I also would love to be able to take refuge in  
12 the defense offered by Miguel that he was forced to be  
13 arrogant. The problem is that there is at least one  
14 member of the audience I see here who was one of my law  
15 school classmates, so he knows darn well that I have  
16 chosen to be arrogant. So, what I would like to say  
17 honestly is that I am going to sound more assured about  
18 my views than I am. I have asked that on my tombstone  
19 they write something like, "Often wrong but never in  
20 doubt," so if you really do not like what I am saying,  
21 say, "Oh, Tom's just trying to be provocative again."  
22 Dave can tell you that he has said that many times and  
23 enabled himself to get home without going home in a funk  
24 or thinking that they have to let me go the next day.

25 The other thing I want to say at the beginning

1 is that aside from the fact that I am quite honestly  
2 flattered to have been invited to join this group, I am  
3 more interested in trying to respond to questions than  
4 saying anything in particular, so please do send up a  
5 flag after 10 or 15 minutes, and I will just stop. I  
6 have four points to make, and if we only get three of  
7 them out, I am sure I will be able to smuggle the fourth  
8 one in somewhere later on.

9 I am speaking largely off a text -- I am not  
10 going to read it to you -- of an article that I  
11 published with a couple of really outstanding antitrust  
12 lawyers and scholars, Bob Lande and Steve Salop in the  
13 Georgetown Law Journal in 1987 called Monopoly Power and  
14 Market Power in Antitrust Law. It turns out that even  
15 though that is 20 years ago, I think it is still right,  
16 so if you want to have a look at that, that is where I  
17 am coming from.

18 The first point I wanted to make I think is one  
19 where we could say I am preaching to the choir, so I  
20 will go through it quickly, but it is not a trivial  
21 point, and that is, what do we mean by market power? I  
22 think my sense is that in this room, we are all  
23 co-religionists; that is, we all think that market power  
24 is the ability to price profitably for a significant  
25 period of time above the competitive level for that

1 market.

2 I might just stop to observe that that has  
3 hardly been the history, the unbroken history, of  
4 antitrust. We have had many other tests of whether  
5 something is anticompetitive or not. Justice Douglas  
6 once opined that a merger was anticompetitive because it  
7 would lead to moving the corporate headquarters of the  
8 firm from a small town on the West Coast to big, bad New  
9 York City. Justice Black once told us that a merger was  
10 anticompetitive because there would be fewer  
11 single-store grocery stores in Los Angeles.

12 We seem to have, at least at this point in time,  
13 a consensus that we have an economic concept of market  
14 power, and it is the ability profitably to price above  
15 competitive levels for a significant period of time, and  
16 I know that for crystallizing that definition, one of  
17 the people we really have to thank for that is Greg.

18 Another question that I think I was asked to  
19 address is what is the difference between monopoly power  
20 and market power? Now, syntactically, "monopoly" sounds  
21 like -- it says, well, how can you have monopoly power  
22 unless you have complete control over a relevant market?  
23 You must have to have a 100 percent share of a relevant  
24 antitrust market that is surrounded by entry barriers.  
25 I suppose -- I do not know, I didn't look at a

1 dictionary, I should have -- you could say that is it.

2 That is certainly not the case law definition,  
3 and I think, again, within the current antitrust  
4 community, nobody would doubt that. I think the right  
5 answer is that it is the same as market power. There  
6 are some cases out there where there is noise in the  
7 opinions that suggests that there is some kind of  
8 difference between market power in monopoly power, but  
9 it does not seem to make any sense. That is, market  
10 power and monopoly power and antitrust law are and  
11 should be synonymous. They can occur in various  
12 degrees, but they are qualitatively the same.

13 Of course, the analogy that came to my mind was  
14 basketball. I am supposed to leave here tonight and  
15 play in a basketball game. Yes, you can tell by looking  
16 at me I am our team's power forward, and monopoly power  
17 and market power are the same in the same sense that a  
18 shot is the same. It goes in or it does not go in. It  
19 goes in the basket or does not go in the basket.

20 Now, some are worth one point, some are worth  
21 two points, some are worth three points. You could have  
22 lots of market power or little bits of market power, but  
23 it is the same thing. It is not like being tall. You  
24 could be very tall or not very tall or sort of tall,  
25 but -- no, this is like shots in basketball.

1           I guess I have waited long enough for some way  
2 to say, "Well, what about goal tending?" The answer to  
3 that, "If you figure that out, you have got the whole  
4 rationale for the per se rule," but you did not want me  
5 to talk about per se rules? Okay, I will go to the next  
6 thing.

7           Market power, monopoly power, are really the  
8 same thing. They are qualitatively the same thing. We  
9 mean the same thing by it. It is helpful to distinguish  
10 between I think two types of market power. The DuPont  
11 formulation that is quoted a lot is that monopoly power  
12 is -- DuPont is the same one that introduced the  
13 Cellophane fallacy -- the power to control prices or  
14 exclude competition.

15           That sounds like it is two things, doesn't it?  
16 Power to control price or the power to exclude  
17 competition, arguing it is really the same, but the  
18 reason you see that or the reason you sometimes see this  
19 noise in the cases about there are these different  
20 things is that the intuition the judges have is that it  
21 might make a difference what kind of market power you  
22 have or how you are exercising it. We put names on them  
23 in the paper, but I do not have to use names.

24           One way to exercise market power is by  
25 restricting your own output, cutting your own output,

1 sometimes in concert with that of other people in the  
2 market who are happy to join with you. I would call  
3 that collusive market power. We called it Stiglerian in  
4 honor of George Stigler because it is the kind of market  
5 power he wrote about.

6 The other way that one might exercise market  
7 power is not by restricting one's own output but by  
8 restricting rivals' output, letting market output  
9 decline and letting your price rise through no  
10 restriction in your own output. That I would call  
11 exclusionary market power or market power obtained or  
12 exercised by exclusionary means. In the paper we called  
13 it Bainian, after Joe Bain, an economist who had written  
14 a lot about entry barriers and exclusionary issues.

15 My second submission to you is that -- while  
16 market power and monopoly power are the same kind of  
17 concept and that we do have a notion of what it means  
18 that we tend to agree on -- that it will help us if we  
19 distinguish between whether we are talking about  
20 collusion or exclusion, or if you like the little  
21 labels, Stiglerian or Bainian market power. Now, why is  
22 that the case?

23 The article is about market power in antitrust  
24 law. We are here talking about section 2. So, let me  
25 try to explain with respect to section 2 cases, monopoly



1 or attempted monopoly cases, why it might make a  
2 difference to think about the source of the market power  
3 or the type of market power that we are talking about.

4 Point one, market and monopoly power include the  
5 power to keep prices from falling to competitive levels.  
6 I do not think we forget this a lot. We usually just  
7 say it is the ability to raise prices, but when  
8 confronted with the ability to keep prices from falling,  
9 we usually recognize that as market power, but you  
10 should in case you did not.

11 If you had a horse and buggy industry that was  
12 perfectly competitive, a hundred firms each producing 1  
13 percent of all horse and buggy output, if they managed  
14 to exclude one firm and that firm was the first firm  
15 that was going to produce the automobile, they have  
16 nevertheless exercised market power even though it was a  
17 completely competitively organized industry. It is  
18 market power. It is market power to be able to keep  
19 prices from falling to competitive levels. Fencing out  
20 rivals who have the ability to bring in a new technology  
21 or simply be able to produce products at a much lower  
22 cost is an exercise of market power.

23 Secondly, and connected to that, I believe it is  
24 not correct to insist on a threshold showing of market  
25 power if the conduct complained of is acquisition and

1 exercise of market power by excluding rivals. If you  
2 are talking about a section 2 monopoly case, and you are  
3 saying what they are going to do is restrict their own  
4 output and profitably price for a long time above  
5 competitive levels, it is probably correct for the  
6 reasons that Simon and Miguel have already talked  
7 about -- although it was not the principal purpose of  
8 their talk, but they explained it -- to insist on some  
9 kind of threshold of market power. It is kind of hard  
10 to imagine how a firm with only 40 percent of the market  
11 can restrict its own output profitably for a long period  
12 of time and thereby price above competitive levels all  
13 by itself.

14 That is not true if you are talking about  
15 exclusionary behavior. Exclusionary behavior can create  
16 the market power. You do not necessarily need to  
17 already control a market in order to be able to engage  
18 in exclusionary behavior that winds up creating  
19 effective market power. You might still have a  
20 threshold.

21 If you do the math, he said -- referring to  
22 other people because he is not a mathematician -- but if  
23 I understand the literature right, the raising rivals'  
24 costs literature, you may want to have kind of a  
25 threshold that does have to do with size, like relative

1     disparity in size.  It is unlikely that a firm that has  
2     got 5 percent of the market is going to be able to,  
3     through exclusionary tactics, drive out rivals who are  
4     two and three times as big if it were the smallest firm  
5     in the market, but to say that one needs to have a kind  
6     of a dominant firm presence before one could ever be  
7     tagged with the offense of monopolization under section  
8     2 is just not right unless you are -- because you appear  
9     to be forgetting what I've called Bainian or  
10    exclusionary market power.

11           A third lesson from this that is relevant to  
12    section 2 cases, I think, is that it seems to me that we  
13    frequently hear it said that the mere exercise of market  
14    power is not prohibited by antitrust, and I think there  
15    is a statement to that effect in the Trinko decision by  
16    the Supreme Court a year and a half ago.  Indeed, if I  
17    recall correctly, Justice Scalia not only said it, but  
18    he said you sort of welcome that kind of behavior  
19    because it is a signal to people to come enter the  
20    market.  There are high prices.  You can come in and do  
21    something.  There is nothing wrong with exercising  
22    market power if you have got it.  The question is how  
23    you got it.

24           Well, once again, I think that probably is true  
25    for collusive or Stiglerian market power.  It is

1 probably correct that a firm that has got 90 percent of  
2 the market, if they acquired it lawfully, to say that  
3 when they raised -- when they restrict output and raise  
4 price, that is an antitrust offense, that is a very  
5 tough nut to crack, a very hard argument to make,  
6 because what are you going to do about it? What is your  
7 remedy? How are you going to decide whether they raised  
8 price too high?

9 But if you have in mind the possibility that you  
10 might be talking about a section 2 case based on  
11 exclusionary market power, it is just not right, because  
12 you would attack the exclusionary act, and sometimes you  
13 can distinguish between the exclusionary act and other  
14 types of behavior with respect to the market power. The  
15 most obvious example would be, I think, if I could build  
16 off Miguel's example.

17 He gave that terrific example of the industry  
18 where, when you first looked at it, you might think  
19 dominance, and then you find all these other aspects  
20 here. If this had been an industry in which the issue  
21 had been an exclusive dealing arrangement that was  
22 having the effect of denying vital inputs to rivals, not  
23 only does it not require, in order for that to be a  
24 successful antitrust strategy, that the firm have a  
25 dominant share to begin with, but it is also not the

1 case that if it has got a position of dominance, if it  
2 is a monopoly, that then the mere exercise of monopoly  
3 power is permissible. It is not the case at all, and,  
4 indeed, that is an area where I think the European law  
5 is ahead of ours, because it clearly reflects that is  
6 the abuse of dominance.

7 Finally, I had one more. It is relevant to  
8 antitrust law, but it is not relevant to the Federal  
9 Trade Commission or the Department of Justice. One of  
10 the lovely things about working for the -- there are  
11 many nice things about working for the FTC and the  
12 Department of Justice that I think, you know, the most  
13 are that you always think you are on the right side and  
14 you have these wonderful people to work with, but  
15 another thing is you never have to worry about standing,  
16 because if you see something wrong out there, you can go  
17 after it.

18 Out in the private sector, you have got to have  
19 standing, and I think another lesson that you learn from  
20 distinguishing between these types of market power or  
21 these types of means of acquiring or exercising market  
22 power is relevant to competitor standing. Competitor  
23 standing should not be an issue in most section 2 cases  
24 involving Bainian or exclusionary market power, because  
25 the action is actually targeted at the competitor.

1           On the other hand and for the same reason,  
2           consumer standing, even though the person who may suffer  
3           the effects is the consumer, consumer standing may be  
4           quite risky, both because there is a more direct subject  
5           of the harm, that is, the competitor, and therefore,  
6           there is the risk of double damages, and so following  
7           things like Associated General contractors and Illinois  
8           Brick, consumer standing in monopoly cases may be  
9           difficult, and consumer standing in attempted monopoly  
10          cases I don't think the Supreme Court has ever addressed  
11          it, but there is a growing body of case law in the lower  
12          courts now that consumers just do not have standing to  
13          bring attempted monopoly cases.

14                 Most section 2 cases are these Bainian  
15          exclusionary power type, and you can see the reason for  
16          that is that the harm is not directed at the consumer,  
17          and if it is merely an attempted monopoly, there is no  
18          follow-through on the part of the consumer.

19                 Well, enough for that commercial. Again, I have  
20          tried to suggest really just two things to you. One is  
21          that we have a concept of market power that we are at  
22          least presently comfortable with, and that is no  
23          different from the notion of monopoly power for the same  
24          reason that we are comfortable with the conception of  
25          market power. We are talking about what is the goal of

1 antitrust, what are we trying to target our antitrust  
2 rules to do, and it is to prevent undue concentrations  
3 of power where power means the ability to profitably  
4 price above competitive levels for a significant period  
5 of time.

6           Secondly, that it will help to keep your eye on  
7 the ball, to dig a little bit deeper and say, are we  
8 talking about market power that is going to be  
9 manifested by restricting one's own output, either by  
10 one's self or in concert with one's competitors, or are  
11 we talking about market power that is going to be  
12 manifested or acquired by driving one's rivals out of  
13 the market and thereby gaining the power to exercise  
14 higher prices without necessarily restricting one's own  
15 output? I think it has a number of potential lessons  
16 for section 2, and maybe we will explore some more about  
17 that as we talk through the questions.

18           MR. WALES: Thanks, Tom.

19           (Applause.)

20           MR. WALES: Okay, next up we have Irwin Stelzer.  
21 Irwin is a Senior Fellow and Director of Hudson  
22 Institute's Economic Policy Studies Group. Prior to  
23 joining the Hudson Institute, Dr. Stelzer was Resident  
24 Scholar and Director of Regulatory Policy Studies at the  
25 American Enterprise Institute. He also is a U.S.

1 economic and political columnist for The Sunday Times  
2 and The Courier Mail, a contributing editor of The  
3 Weekly Standard, and a member of the board of the  
4 Regulatory Policy Institute at Oxford, a member of the  
5 Advisory Board of the American Antitrust Institute, and  
6 adviser to the U.S. Trade Representative.

7 Dr. Stelzer founded National Economic Research  
8 Associates, NERA, and served as its president for many  
9 years. He also served as a Managing Director of the  
10 investment banking firm Rothschild, Inc., and Director  
11 of the Energy and Environmental Policy Center at  
12 Harvard. His academic career includes teaching  
13 appointments at Cornell, the University of Connecticut  
14 and NYU. He has been elected a visiting fellow at  
15 Nuffield College, Oxford, and he is a former member of  
16 the Faculty of Practicing Law.

17 DR. STELZER: Thank you very much. Can you hear  
18 me in the back? Thank you for inviting me to this,  
19 although I fear I may be sailing under false pretenses.  
20 Let me clear up one of them. Although I am at the  
21 Hudson Institute, I do not want to appear here as  
22 somebody who is a disinterested scholar. I do have  
23 clients, some of whom are accused of being dominant,  
24 others of whom think dominant firms pick on them, but my  
25 views go back before most of you were born. I, too,



1 still play basketball, but I have learned a trick, which  
2 is I yell "Get that rebound" to other people.

3 I am going to leave any comment on specific  
4 cases to my co-panelists, because they are more familiar  
5 with them than I. I will say, if I am permitted one  
6 vignette, I gave up trying to be involved in specific  
7 cases when I was sitting on a witness stand in Tucson,  
8 Arizona, and the judge summoned counsel to the bench and  
9 said, "We have to talk about schedule." The first  
10 lawyer said, "Well, you know, my daughter's getting  
11 married in May, and that's going to tie me up." The  
12 other guy said, "Well, you know, in June, I really was  
13 planning a fishing trip." The judge said, "Well,  
14 September, I cannot really do," and so they put  
15 everything off about a year. In the middle of this, I  
16 said, "Can I tell you something about my schedule, Your  
17 Honor?" He said, "Don't be ridiculous." I suddenly  
18 realized three lunatics were deciding how I was going to  
19 live my life for the next year, and I am not doing this  
20 anymore. So, I speak to you as a person who used to  
21 testify in these cases.

22 I have submitted a much longer, unconscionably  
23 long paper, which I assume is available to those who  
24 want it, and I will therefore restrict my comments to a  
25 very few, and also, I want to try out ideas. I am not

1 wedded to what I am about to say. I assumed we were  
2 here to try out ideas, not to hand down edicts, and I  
3 thought that is why I would try concentrating on pricing  
4 practices by dominant firms.

5           Simon Bishop said if you are dominant the  
6 practice is questionable; my feeling is if the practices  
7 are questionable, you are probably dominant. Simon says  
8 he is a bit more humble than doing away with market  
9 definition. Those of you who have ever tried to do any  
10 market definition know that only the non-humble would  
11 attempt the elasticity measurements and the other things  
12 involved in it. So, the notion that we must begin with  
13 market definition because that is somehow a constraint,  
14 and anybody who has read any decisions of the EU knows  
15 that it is a very, at best -- you defined it as a loose  
16 constraint. I think it is looser even than that.

17           I am not certain that going through the agony of  
18 market definition gives you a degree of precision, some  
19 sort of constraint on the examiner. It may, but  
20 given -- if you go through it, I am not so sure that  
21 beauty is in the sight of the beholder as with any other  
22 part of economic analysis. I am not wedded to market  
23 definition, and I would like to explore the possibility  
24 that we might want to do away with that exercise  
25 altogether in deciding about dominance.

1           I recognize that that would unemploy half of the  
2 economics profession, leaving only that part that knows  
3 about exclusionary practices still existing, but I do  
4 think we should think -- think -- about the possibility  
5 that defining relevant markets, defining product  
6 characteristics, all of that is a kind of very elastic  
7 process that we could do away with.

8           Let me suggest instead -- and I really mean  
9 suggest. There is this kind of academic politeness  
10 about "let me suggest," meaning "I really know that." I  
11 do not use the language that way. I really mean to  
12 suggest that we consider that it is the practices that  
13 reveal dominance and not dominance that reveals the  
14 practices.

15           I have read some of the proceedings, and it  
16 seems to me there is a great deal of sort of motherhood  
17 and apple pie stuff in this record. It is certainly  
18 true, we do not want to prevent vigorous competition  
19 that results in lower prices to consumers. Who would  
20 want to prevent vigorous competition? Certainly  
21 Microsoft did not want to prevent vigorous competition,  
22 it says. Yes, we want firms to develop pricing plans  
23 that benefit consumers; yes, we want to give businessmen  
24 as much certainty as possibility; and yes, we want to  
25 reduce the role of lawyers in the board room and leave

1 it to businessmen. But I do not think that means that  
2 pricing practices should be unscrutinied by antitrust  
3 enforcement authorities regardless of any finding of  
4 dominance.

5 What we do not want to condone is long-term harm  
6 to the competitive process, therefore to consumers, by  
7 approving short-run price reductions aimed at creating  
8 barriers to entry or preserving market positions that  
9 are unrelated to efficiency. Now, again, I would not  
10 try to measure efficiency of a firm, because I do not  
11 think I know how to do that. There may be people who  
12 know how to do that, and when people say to you they are  
13 going to measure costs, they are going to compare costs,  
14 I would urge any one of you who agrees that that is a  
15 terrific idea to determine any cost of any large firm,  
16 and you tell me what range you think would make you feel  
17 comfortable in that determination, especially since you  
18 are usually dealing with someone who does not want you  
19 to find out, and so I think you are going to have a very  
20 difficult problem.

21 What you have to do is examine a firm's pricing  
22 practices in the context of the firm's total behavior.  
23 You cannot look at a thread in a tapestry in order to  
24 get a picture of whether or not a firm is engaging in  
25 exclusionary practices.

1           I will give you an example. If you had in the  
2 record that a firm had offered a million dollars to a  
3 customer not to deal with a competitor, you would say,  
4 "Well, gee, we can't tolerate that." But it is very  
5 easy to manipulate a pricing schedule in a large  
6 multi-product firm to accomplish the exact same thing,  
7 to reduce the cost of the incremental order to pretty  
8 close to nil by simply manipulating the pricing  
9 schedules and the relationship of past to future  
10 deliveries.

11           In other words, it seems to me, again, that  
12 firms spend millions, hundreds of millions, on discovery  
13 in antitrust cases, and the discovery is really  
14 discovery that will tell you whether the firm is  
15 dominant, whether the firm is engaging in exclusionary  
16 practices, with far greater certainty than would any  
17 measure of its market share.

18           I think, also, you can tell -- I hate to use  
19 this word because I think it is old-fashioned -- you can  
20 divine intent from looking at what discovery turns up.  
21 Now, by that I do not mean that the statement by an  
22 enthusiastic salesman who says "I just rubbed out the  
23 competition in Florida" or something like that should be  
24 taken at face value, but I think you can determine the  
25 intent of a variety of competitive weapons wielded by a

1 firm by examining the entire record of its behavior,  
2 which brings me to the last question -- I said I would  
3 not take my full time -- and that is, has what I just  
4 said reduced certainty?

5 A lot of my clients talk about certainty, they  
6 want certainty, so you say, "Well, you want certainty?  
7 There are two kinds of certainty you can have.  
8 Everything you do is subject to a per se rule. That is  
9 certainty. How about that?"

10 "No, that is not what I particularly had in mind  
11 by 'certainty.'"

12 "Well, the other form of certainty is to say,  
13 'Well, almost everything you do is okay.'"

14 "Well, I think that is lousy public policy."

15 Certainty is simply not available in this  
16 business. That is it. It is good for the lawyers. It  
17 is bad for the businessmen. In making their decisions,  
18 they have to listen for counsel and decide what to do  
19 about the legal advise they get. It is simply one  
20 aspect of the many risks they take, just like guessing  
21 at interest rates. Certainty is not there. It cannot  
22 be had unless some of the more distinguished members of  
23 this panel can give it. I cannot.

24 Thank you very much.

25 (Applause.)

1           MR. WALES: Last, but not least, we have Joe  
2           Sims. Joe is a senior antitrust partner at Jones Day  
3           here in D.C. His practice is concentrated on antitrust  
4           and related areas of governmental regulation and  
5           includes litigation counseling, agency practice before  
6           state and federal courts, antitrust enforcement agencies  
7           and various specialized agencies where competition  
8           policy or antitrust issues arise. Joe is a member of  
9           the American Bar Association, Antitrust Law Section, and  
10          has served as chair of numerous committees on the  
11          Antitrust Law Section. He's a Fellow of the American  
12          Bar Foundation and a member of the American Law  
13          Institute. He regularly writes and lectures on  
14          antitrust and related subjects and is listed in The Best  
15          Lawyers in America, The World's Leading Lawyers, and  
16          Who's Who Legal.

17                 Joe, thanks.

18           MR. SIMS: Thank you, Dave.

19                 Let me start with a point about my perspective,  
20          which will also be true for at least Irwin and Tom. I  
21          had the revelation when preparing for this and looking  
22          back at some of the older cases that I have been  
23          practicing antitrust law for about a third of the time  
24          that we have had antitrust laws, which is kind of a  
25          scary thought if you think about it, but it is true

1 nonethless. A little depressing, too.

2           During that time, no one has ever confused me,  
3 unlike most of these people on the panel, as a scholar.  
4 I do not cite footnotes in cases. Sometimes I cannot  
5 even remember what a case holding was. I do not write  
6 law review articles. I write commentaries, not as  
7 eloquent as Irwin's commentaries, but it is a less  
8 taxing discipline than law review articles. So, I view  
9 my role here as offering the practice perspective. I  
10 know Tom is a practicing lawyer, but his scholarship is  
11 so impressive that I have always viewed him as an  
12 academic at heart. So, I am going to approach what I  
13 have to say in that light, focusing not on the theory,  
14 but on the practice.

15           Fortunately, jurisprudence and for that matter  
16 economics and antitrust is very heavily fact-weighted.  
17 The jurisprudence and the economics almost always take a  
18 back seat to the facts, at least in the long run.  
19 Antitrust law in the United States, where it is really  
20 law enforcement and not regulation, is mostly about the  
21 facts and how the facts are presented. This is true  
22 whether you are talking about agencies or judges. It is  
23 certainly true when you are talking about juries.

24           Of course, the case law is important. Bad case  
25 law is not desirable. It is a good idea, if we can,



1     which we do now and have from time to time, have  
2     competent, intelligent people running the antitrust  
3     agencies, but all of that fades in importance to the  
4     unique facts at play in any particular case.

5             During at least my practicing lifetime, we have  
6     moved steadily away from what we used to spend a lot of  
7     time at, which was antitrust by sloganeering, to more  
8     careful analysis of the facts.  If you remember, Derek  
9     Bok called for more certainty and bright line rules in  
10    section 7 cases more than 30 years ago.  Well, that  
11    actually had some resonance for a while, but that  
12    concept was seriously injured by Bill Baxter's Merger  
13    Guidelines and probably finally killed by the 1992  
14    edition of the Guidelines.  When the analysis focuses on  
15    competitive effects and not on market shares or  
16    concentration or other slogans, the notion of broadly  
17    applicable bright lines disappears.

18            So, today, in merger cases, we do not really  
19    have any clear rules.  All the facts are in play.  Every  
20    case is unique, and while the outcome needs to comport  
21    generally with stated case law and regulatory guidance,  
22    the operative word is "generally."

23            This is equally true in section 2 matters.  We  
24    have come a long way from American Tobacco or Alcoa or  
25    even Grinnell, which I was shocked to see was decided

1 just four years before I graduated from law school. It  
2 seems like a very old case, and with some obvious  
3 exceptions, like, Aspen Ski and maybe Kodak, the general  
4 direction of Supreme Court decisions over my lifetime  
5 has been to gradually cabin in the reach of section 2,  
6 in significant part by insisting upon a focus on the  
7 facts as opposed to reliance on the mostly populist  
8 rhetoric about market dominance and relative size that  
9 dominated section 2 jurisprudence in earlier times.

10 A good deal of this, of course, reflects the  
11 fact that our markets have matured -- that many more  
12 markets today, maybe most markets, are truly  
13 contestable, which was not always the case -- but  
14 nevertheless, we do not have very many clear rules in  
15 section 2 today.

16 I think this is generally a good thing, but it  
17 does, as Irwin pointed out, inevitably carry with it  
18 uncertainty of outcomes in particular cases. I noticed  
19 in looking back at some of the earlier hearings that the  
20 Microsoft representative, perhaps understandably, took  
21 the position of wishing that there was more clarity in  
22 the law. It is a common business position. I think it  
23 is a short-sighted business position.

24 To pick up on Irwin's point, if we really did  
25 have more clarity, we would have more restrictive rules.

1 I do not have any doubt that if you have to choose  
2 between clear restrictive rules and clear unrestrictive  
3 rules, it is where that line would be drawn. I do not  
4 think that would be useful for the public interest in  
5 the long term, and it would not even be useful for  
6 business at least in the medium to long term. It would  
7 make the advisory job easier, but that is about it.

8 So, with this context, these kinds of hearings  
9 are really a great idea, especially if they try, as I  
10 think they have, to take the long view of an important  
11 area of law. More discussion will produce more  
12 understanding and will also demonstrate, as these  
13 hearings pretty clearly have, that there is an enormous  
14 variety of views on section 2 jurisprudence and policy.  
15 Indeed, I would argue that this might be more true today  
16 than it has been in my practicing lifetime.

17 We still have, of course, the strong populist  
18 supporters of very aggressive section 2 enforcement. We  
19 still have plenty of conservative "let the market work"  
20 advocates. But we also today have an incredible variety  
21 of economists and law professors and others who  
22 articulate an amazing range of interesting approaches to  
23 the identification and analysis of market power. Tom  
24 Krattenmaker and Steve Salop obviously are responsible  
25 for maybe the single most visible effort in this field,

1 but there are a lot of people keeping them company with  
2 new and interesting ideas, including, of course, Greg  
3 Werden and others on this panel.

4 So, there is no end to possible options for new  
5 section 2 approaches, but there is also clearly no  
6 consensus on any particular approach, with the possible  
7 exception that we really ought to pay attention to the  
8 facts. It is very hard for me to imagine how we can  
9 productively create clear rules or safe harbors for  
10 section 2 using market shares or, for that matter,  
11 anything else. Given this lack of consensus on where we  
12 ought to draw the lines and the truism, that, at least  
13 over the long run, markets are a lot better at  
14 identifying and responding to consumer demand than  
15 courts or regulators or most academics, the chances of  
16 finding consensus bright lines that really do advance  
17 the public interest are pretty low. But it is  
18 nonetheless worth talking about, and so these hearings  
19 are a good idea.

20 Any legal discipline like antitrust where the  
21 operative legal standard is in one form or another the  
22 rule of reason is going to be messy and unpredictable.  
23 Facts are highly variable, and their perception and  
24 analysis by humans is even more so. There is the  
25 additional problem that courts and regulators, even very

1 thoughtful ones that take the time to think about and  
2 listen to various points of view, are inevitably better  
3 at evaluating the past than they are at predicting the  
4 future. They are too often focused on fixing  
5 yesterday's problems without really having a very clear  
6 picture of how that is going to affect tomorrow.

7           Because of this, we ought to try to be cautious  
8 about interfering with markets, doing so only when we  
9 are pretty darn confident that the intervention will  
10 make things better. I have written on this for 25  
11 years, describing (in very gross and simplistic terms,  
12 of course) the two basic approaches in antitrust as "do  
13 no harm" and "can we help". The "can we help" school  
14 tends to be a lot more confident about their and a  
15 court's ability to improve market performance than I am,  
16 but the "do no harm" school has been in clear ascendancy  
17 in the past several years, both at the federal agencies  
18 and at the Supreme Court.

19           This certainly does not mean that it would not  
20 be great if these hearings could find a way to produce  
21 some clear consensus and let us feel comfortable in  
22 drawing some more bright lines like we have in the per  
23 se rule against price fixing, or in the section 2  
24 analog, the below-cost requirement for finding predatory  
25 pricing. But my reading of the results so far -- and I

1 have read at least summaries of all of the hearings --  
2 does not leave me with the impression that we have yet  
3 identified that consensus.

4 As I said, I am not sure this is a bad thing.  
5 One of the most important -- maybe the most important --  
6 reasons the antitrust laws have continued to serve us so  
7 well after more than a century is that they are pretty  
8 darn flexible. Congress, of course, passes a lot of  
9 statutes where, in effect, buck the problem to the  
10 courts or a regulatory agency, but it rarely works as  
11 well as it has in this field.

12 I think that is because, in general and over the  
13 long term, the rule of reason is a pretty accurate  
14 description of what courts really do -- and regulators  
15 too, for that matter. They generally try to figure out  
16 what is reasonable under the circumstances with a strong  
17 bias most of the time -- let's put the Robinson-Putman  
18 Act to the side as an outlier -- toward leaving markets  
19 free to work their magic.

20 As long as this is the operative legal regime  
21 under section 2, we will have uncertainty about  
22 particular cases and there will be uncertainty about how  
23 a particular fact pattern is analyzed. This approach  
24 has costs, of course, including, most importantly, the  
25 inadvertent deterrence of procompetitive behavior, but I

1 suspect the costs are less than would be the case with  
2 either bright line rules that miss the mark or  
3 impractical tests that over-deter because of ambiguity.

4           So, I do not think we really need a whole bunch  
5 of new rules; nevertheless, if we could come up with  
6 them, we should, and so I am glad we are looking at it.  
7 We have to remember, however, that there is a difference  
8 between section 1 and section 2 and a very good reason  
9 for the difference. Section 1 deals with joint conduct,  
10 and while there are many times when joint conduct can be  
11 neutral or procompetitive, there are obvious and very  
12 real circumstances where there are competitive risks  
13 from joint conduct, cartel behavior being the most  
14 obvious. Given this, it is tolerable to have some  
15 potentially overreaching penumbras of illegality,  
16 although as we get more cases like Daugher, even this is  
17 gradually reduced.

18           But Section 2, by contrast, is aimed at  
19 unilateral conduct, and over-enforcement here would  
20 threaten the very essence of competition. We want firms  
21 to be monopolists or to try to be monopolists. The less  
22 risky we make that effort, the less aggressively firms  
23 will try. So, section 2 cases should be hard to bring;  
24 they should be harder to win. Successful cases should  
25 be rare, because true monopolists with durable monopoly

1 power are rare as determined by how hard it is to name  
2 some. It is kind of hard to do, actually.

3 That's why Microsoft was such an attractive  
4 case. It was one of the few instances where you could  
5 look at it and say, "Doggone it, it looks like they do  
6 have a monopoly." If we can devise some rules or  
7 guidelines to help us advance this cause, that is great.  
8 My guess is we cannot, so we ought to let the market --  
9 in this case, the market for judicial decisions over the  
10 long run -- create and enforce the rules, and the result  
11 will be just fine.

12 Thanks.

13 (Applause.)

14 MR. WALES: Thanks, Joe.

15 Okay, as we said, we are going to take a  
16 15-minute break. So, why don't we reconvene at 3:35.

17 Thanks.

18 (A brief recess was taken.)

19 DR. WERDEN: Okay, let's get started again.

20 What we are going to do for the next little  
21 while is start by putting one or two questions to each  
22 of the speakers, in turn, and then letting the other  
23 panelists, if they like, comment on what has been said,  
24 and we are going to take the panelists in the order that  
25 they spoke, so I am going to start with Simon, and my



1 question, Simon, is, while there is clearly a dominance  
2 threshold under Article 82, there really is an open  
3 question as to how high the bar is for dominance, and I  
4 think the way Miguel described it, the bar is and ought  
5 to be quite low. What do you think about that?

6 MR. BISHOP: Okay, well, contrary to what Irwin  
7 might have suggested, most of my clients are actually  
8 dominant firms, so on that basis, I think, you know, the  
9 40 percent threshold, which is enshrined in Article 82,  
10 is a pretty reasonable threshold to have. I mean, if  
11 your market share is below 40 percent, then you can do  
12 whatever you like. If you are above that, then we move  
13 into the effects and the assessment of the behavior  
14 under consideration. It does not mean if you are above  
15 40 percent, what you are doing is necessarily  
16 anticompetitive.

17 DR. WERDEN: But you wouldn't say that all the  
18 firms above 40 percent are dominant, of course, would  
19 you?

20 MR. BISHOP: Absolutely not, and that is why I  
21 said in my talk, you know, the market share is only one  
22 factor. You have got to take into account a lot of  
23 other factors to assess whether that 60 percent, say, is  
24 representative of significant market power.

25 DR. WERDEN: Do any of the other panelists wish

1 to offer a view as to how high the bar should be set in  
2 the United States where I think most observers think it  
3 is set considerably higher than in Europe?

4 MR. KRATTENMAKER: Or whether there should be a  
5 bar at all, I guess.

6 MR. SIMS: But, Tom, wouldn't you say that there  
7 shouldn't be a bar, I would think?

8 MR. KRATTENMAKER: Yes.

9 MR. WALES: So, the answer is there is no bar.

10 MR. KRATTENMAKER: Or what I would say is, bar  
11 to what?

12 DR. WERDEN: Bar to proceeding.

13 MR. KRATTENMAKER: You mean, like, a  
14 post-behavior section 2 case where the claim is what I  
15 called collusive or Stiglerian power? Sure.

16 DR. WERDEN: Well, if you want to go down that  
17 road, in an actual monopolization case, where the  
18 defendant is alleged to have acquired a monopoly, the  
19 courts have set the bar fairly high on what it means to  
20 have a monopoly and generally have required, in fact, a  
21 70 percent share protected by pretty high barriers to  
22 entry.

23 MR. KRATTENMAKER: Yes, right, right. I think  
24 if they acquired that monopoly by, for example,  
25 acquiring a lot of rivals by purchasing firms, that

1 would probably be an appropriate threshold to do. Now,  
2 you do not see cases like that because we have had  
3 section 7, so almost all section 2 cases now are what I  
4 would call exclusionary or Bainian type, and yeah, that  
5 is right.

6 I think it is not correct to say you could not  
7 possibly have market power if you have got 66 percent of  
8 the market.

9 DR. WERDEN: So, in the Microsoft case, if their  
10 share had been 10 percent, you would have looked on  
11 things pretty much the same way?

12 MR. KRATTENMAKER: You know, there were so many  
13 facts at issue in the Microsoft case...

14 No, as I tried to indicate, it does not seem to  
15 me that you utterly disregard market share, Greg, but as  
16 I understand it -- and I am still learning this area --  
17 the ability to exclude can oftentimes be a factor of  
18 relative size, but the idea that it requires dominance  
19 of the entire market I think is quite wrong.

20 DR. STELZER: Given what Microsoft did and  
21 proved itself capable of doing, did you have to bother  
22 measuring its market share? I mean, nobody who didn't  
23 have huge market dominance, i.e., 90, 80, 40, could do  
24 those things, could make an equipment manufacturer pay  
25 them for stuff that was not in the machine. I mean, you

1 have got to have an awful lot of market power to do  
2 that. You want to measure market power because lawyers  
3 make you do it, but as a matter of policy, in the case  
4 of any firm that can pull off what Microsoft pulled off,  
5 you could skip the whole market share measurement stuff  
6 and just say, if they did this, they have market power,  
7 they have abused it.

8 MR. KRATTENMAKER: I probably ought to let Joe  
9 pick up on that, but I will say -- I mean, I know a  
10 little bit about Microsoft. I mean, you might be able  
11 to say that, but if what you are doing is talking about  
12 the part of the case where they allegedly misrepresented  
13 whether their programs -- either how it interfaced with  
14 Java, I do not know that you needed to have a dominant  
15 market share in order to lie.

16 DR. STELZER: No, no, I was talking about where,  
17 if you decided to put a competitor's product in the  
18 machine, they charged you for each machine whether you  
19 put their stuff in it or not.

20 MR. KRATTENMAKER: No, I've gotcha. I take  
21 it -- I mean, I am sympathetic to your viewpoint, but it  
22 is conduct-specific. For certain kinds of conduct, you  
23 might infer market power from the fact of the behavior.

24 DR. STELZER: What they do, I shall know them.

25 MR. SIMS: On this point, I am more with Tom

1 than Irwin, I think, surprisingly enough. Market  
2 definition and whatever you draw from that market  
3 definition is a tool that you want to use when it is  
4 necessary and useful to figure out what the competitive  
5 effects of the conduct at issue are. So, there are some  
6 times -- and Microsoft might well be a good example --  
7 where, careful market definition is not all that  
8 important.

9 MR. BISHOP: But I think, I mean, some of the  
10 difference between the U.S. people at that end of the  
11 table and the Europeans down here is really -- sort of  
12 reflects some of the sort of philosophical,  
13 institutional differences, and I'll say institutional  
14 because I think my personal philosophy is going to be  
15 closer to that end of the table than a lot of Europeans,  
16 and I think that that is a point which Joe talked about,  
17 you know, is do no harm, which is, you know, very much a  
18 high threshold before you would start intervening, then  
19 sure, maybe you don't need a market share bright line  
20 test, but in Europe, the institutional philosophy is  
21 much more -- you know, there are a lot of markets, the  
22 EU, the Commission or the competition authorities can  
23 intervene in to make things better, and in that  
24 situation, in that sort of institutional setup, then  
25 having a bright line test which says, "If you do not

1 have a market share of above 40 percent or whatever, you  
2 can do whatever you like," seems to me an important  
3 safeguard to prevent people coming in and start messing  
4 around with your industry, which is very costly and  
5 potentially extremely disruptive to the firm's business  
6 model if that firm has got no market power at all.

7 DR. STELZER: But that is kind of the "stop me  
8 before I kill again" argument, right? You need --  
9 because you know that you really could be irresponsible  
10 and do bad things, you better have some sort of rule  
11 that stops you from doing it on the theory that the  
12 rule, is the lesser of the evils. It is a substitute  
13 for judgment.

14 MR. BISHOP: No, it's not. It is a substitute  
15 for deciding when a competition authority can bring an  
16 action against a business.

17 DR. WERDEN: Or in the United States, substitute  
18 for a jury trial.

19 MR. SIMS: Well, there is that pretty critical  
20 difference between the U.S. and Europe in that in  
21 Europe, the Commission generally gets to say yea or nay,  
22 and in the United States, the FTC and the DOJ never get  
23 to say yea or nay. Unlike the EU, they have to go to a  
24 court and convince a court.

25 I think what Simon is postulating is that some

1 kind of -- if I could borrow the word -- durable  
2 guidelines that, would last beyond a particular  
3 administration of the Commission and thus constrain the  
4 current occupant of those decision-making positions is a  
5 good substitute, partial though it may be, for what we  
6 have here in the courts.

7 DR. WERDEN: Okay, that was fun. Let's move on  
8 to a question for Miguel.

9 I was very intrigued by your very clear point  
10 that the suspect conduct in an Article 82 case cannot  
11 itself be what creates the barrier to entry that is  
12 required, in turn, for the firm to be dominant, so that  
13 if it was possible to have a firm with a whopping share  
14 protected only by the suspect conduct in the case,  
15 otherwise you would be flooded with competition, then  
16 that firm isn't dominant? Is that your submission?

17 MR. de la MANO: Indeed, and there is the  
18 problem that we have in the EU, that we do not really  
19 have a standard which allows us to pursue attempted  
20 monopolization.

21 DR. WERDEN: No, let the firm be 80 percent. It  
22 is 80 percent, but the only thing keeping out  
23 competition is this guy's anticompetitive conduct. Now,  
24 the guys at the end of the table would go after this guy  
25 at 5 percent it sounds like, but let's put that aside.

1 He's 80 percent, and he's doing bad stuff, and he's  
2 keeping the competition out. If he didn't keep doing  
3 the bad stuff, the competition would come in. They  
4 might even swamp him.

5 MR. de la MANO: So, let me now link that  
6 question to the previous question to Simon, which is  
7 where should we put the threshold for the finding of  
8 dominance, and, of course, Simon has argued 40 percent  
9 might be a good place. I am not sure it is a good  
10 place, and there are a number of reasons why 40 percent  
11 might be too high.

12 First of all, dominance is going to be a  
13 necessary requirement, and in some cases, like the  
14 situation you just presented, it may well be that if the  
15 practice is preventing entry in the market, but in  
16 assessing dominance, what we are ultimately assessing is  
17 the situation without such practice. That's why  
18 dominance is a screen. In a case like that, it would  
19 not be possible to be brought forward by the European  
20 Commission.

21 Now, that clearly -- you might say, "Well,  
22 that's wrong," and that's why you have attempted  
23 monopolization in the U.S. and we do not have it, but a  
24 second reason why if dominance acts as a screen, we have  
25 to be very careful in not setting the market share



1 threshold for a finding of dominance far too high.

2           There is a third reason, which is, as has  
3 already been highlighted by Simon before, which is  
4 market definition is an imprecise exercise. Now, I  
5 think everybody here will argue that in some cases, if a  
6 company has a share slightly above 40 percent, slightly  
7 below 40 percent, you know, it probably doesn't make  
8 much of a difference, but if you have a threshold at 40  
9 percent, it is critical.

10           So, even though in practice, a firm with 35 or  
11 45 percent is probably likely to have much more -- the  
12 same kind of market power, in theory, this is a  
13 threshold at which it either -- the Commission is going  
14 to intervene or not, whereas if you had a lower  
15 threshold -- and, of course, market definition is going  
16 to be critical there. It is going to determine whether  
17 or not the Commission is going to intervene or not. If  
18 you have a lower threshold, then the precision of the  
19 market definition exercise matters much less, because if  
20 you had it wrong and the market definition was actually  
21 too narrow or too wide, but you are wedding yourself  
22 into the 20-30 percent threshold, it doesn't really  
23 matter.

24           As long as you are below 25 percent, even if  
25 you've got market definition wrong, it is for certain,

1 almost for certain, that there are going to be no  
2 problems, and therefore, there should be no intervention  
3 whatsoever.

4 DR. STELZER: To ask a practical question, what  
5 makes you look at something in the first place? You go  
6 into a bunch of market share studies and you say, "Oops,  
7 here's a 40-percenter, I'll go after him"? Or is it  
8 some practice that makes you look?

9 MR. de la MANO: The latter, essentially a  
10 complainant would --

11 DR. STELZER: Simon says no.

12 MR. BISHOP: Well, Miguel said it right. It is  
13 some complainant submits a case.

14 DR. STELZER: Right. Now, as I understand the  
15 EU attitude, it differs from the American. Here my  
16 economist friends believe that if the complaint comes  
17 from a competitor, it is therefore tainted somehow. It  
18 is the use of the legal system as a strategic device.  
19 That is different from the EU, and I think the EU is  
20 right but is the EU sticking with the notion that the  
21 fact that a complaint comes from a competitor does not  
22 taint the complaint?

23 MR. de la MANO: Well, practically in all  
24 cases -- probably in all cases that I have been involved  
25 in, the complaint has come from the competitor, some

1 outliers where a consumer may bring the case, but it is  
2 very, very rare. When that happens, because we have an  
3 opportunistic system, the Commission, of course, has to  
4 take in mind the private interests of the complainant  
5 and how that might taint their submissions, but  
6 ultimately the Commission is obliged to give its  
7 decision, whether it is a decision to intervene, and  
8 therefore -- and that would be trying an independent  
9 objection sent to the dominant company or allegedly  
10 dominant company, or there would be a rejection of the  
11 complaint, which would be a formal rejection, would be  
12 written and sent to the complainant.

13 So, either way, the Commission basically has to  
14 make up its mind, and in doing so, has to definitely  
15 take into account to find out if the evidence that has  
16 been brought forward to it is submitted by parties which  
17 have their own interests at heart.

18 DR. WERDEN: Tom, I have a question for you.  
19 You seem to be saying that the mere exercise of  
20 exclusionary market power is a section 2 offense all of  
21 the time, but I want to clarify if you mean without  
22 regard to the potential of that conduct to create or  
23 maintain something we would call monopoly power.

24 MR. KRATTENMAKER: I do not mean that.

25 DR. WERDEN: Okay, that's great.

1 MR. KRATTENMAKER: Thank you.

2 DR. WERDEN: Anybody want to follow up on that?

3 MR. KRATTENMAKER: Irwin says no.

4 DR. WERDEN: Well, say it out loud.

5 DR. STELZER: But brevity is so much the soul of  
6 wit that I hated -- I just preferred to let your answer  
7 hang out there.

8 MR. KRATTENMAKER: Sort of like a beautiful  
9 arcing three-point shot that's probably right dead bang  
10 through, nothing but the net, exactly, just let it sit  
11 there.

12 DR. STELZER: Right, see, but I play basketball  
13 at 10,000 feet.

14 MR. KRATTENMAKER: Of course you do. You are a  
15 good guy.

16 DR. STELZER: I was trying out ideas. I am not  
17 sure. Tom, tell me why you think about that.

18 MR. KRATTENMAKER: Oh.

19 DR. STELZER: How, as a practical matter, you  
20 would tell in a case.

21 MR. KRATTENMAKER: Because there is lots of --  
22 because the whole point about the competitive process is  
23 to beat your rivals, and so inferring from the fact that  
24 practice has an untoward effect on rivals, that it  
25 therefore violates the antitrust laws, it is just too --

1 to coin a phrase -- over-inclusive.

2 DR. STELZER: Yeah, okay, but -- I guess I was  
3 thinking in terms of defending the competitive process,  
4 not competitors.

5 MR. KRATTENMAKER: Yeah, right.

6 DR. STELZER: And that's harder.

7 MR. KRATTENMAKER: Well, I agree. I mean, the  
8 fact that you inflict some sort of inefficiency on your  
9 rival, you could say, "Gee, that's bad, and we ought to  
10 stop it," and that's kind of like the Klor's case.  
11 That's Klor's against Broadway-Hale. I mean, they might  
12 have done something bad, and we could care for less that  
13 there were a hundred other stores in that city, and, I  
14 mean, there is a way I used to tell that. I mean, I  
15 went back to the record and examined that case, and it  
16 turns out that the reason that there was this dispute  
17 here was that the owner of Broadway-Hale had a  
18 ne'er-do-well son who had impregnated and run away with  
19 the daughter of Klor's, and this was an alienation of  
20 affection suit brought as a Sherman Act case.

21 Now, of course, that is not true, but I tell  
22 that story and the students believe it, and so that's  
23 the long way of saying I do not think that section 1 --  
24 of course, we are not talking about section 1 -- was  
25 meant to federalize the tort of alienation of affection.

1 So, not only are you supposed to beat up on your rivals,  
2 but not everything you do to your rivals is either  
3 necessarily commercially motivated or motivated to drive  
4 monopoly profits.

5 MR. SIMS: And, Irwin, if you don't demand that  
6 the conduct have at least a high likelihood of creating  
7 durable monopoly power, then you really do have a  
8 serious risk of sticking your nose into the market where  
9 you are going to do more harm than good, because  
10 differentiating between exclusionary practices on some  
11 grounds other than whether they have the potential to  
12 create durable market power seems to me to be very hard.

13 DR. STELZER: But you used the term "durable"  
14 about five times. What do you mean?

15 MR. SIMS: I mean more than temporary.

16 MR. KRATTENMAKER: There you go.

17 DR. WERDEN: Your turn, Irwin, as if you haven't  
18 talked enough.

19 You seem not to at all be a fan of limiting  
20 principles, and I want to push the limit on limiting  
21 principles. Are you suggesting, for example, that the  
22 Brooke Group rule was a really bad idea?

23 DR. STELZER: I don't have any idea.

24 DR. WERDEN: You don't think that in a predatory  
25 pricing case, a plaintiff should have to show pricing

1 below some measure of cost?

2 DR. STELZER: Oh, no, I think that's ridiculous,  
3 and I'll tell you why. First of all, I don't believe  
4 you can measure marginal cost. I've spent a lot of time  
5 trying to do that.

6 DR. WERDEN: The courts do not like marginal  
7 cost either.

8 DR. STELZER: I'll take any kind of cost you  
9 want. I don't think you can do it. I've been in enough  
10 proceedings at regulatory agencies where people are  
11 supposed to measure costs to know that.

12 Second of all, the real question with predatory  
13 pricing is not whether the person prices below or at  
14 some concept of cost and has a prospect of recoupment,  
15 but think of it this way. You are walking along and you  
16 want to have a picnic, and there's a sign that says, "No  
17 trespassing." You figure, what the hell. You throw  
18 down your blanket, you have a nice picnic, and you  
19 leave, right?

20 Now you are walking along and there's another  
21 field where you want to have a picnic and there's a no  
22 trespassing sign, and there are about four or five  
23 corpses lying around. Are you going to have a picnic  
24 there? I don't think so.

25 So, what we are talking about is the kind of

1 practices that are entry-detering in the technical  
2 jargon, that scare the hell out of people, because  
3 remember, this is more and more an age in which the  
4 financing of new companies is done by venture  
5 capitalists, and if you have ever been to a meeting with  
6 a venture capitalist -- these are not very nice people,  
7 many of them -- the first thing they want to know is  
8 what is the range of practices available to the  
9 incumbent competitors to keep you out or to destroy you  
10 if you get in. That is what they want to know.

11 I mean, have you got a good idea? Yeah. Are  
12 you a pretty good manager? Yeah. Can I suck most of  
13 the value out of your enterprise? Yeah. And then they  
14 want to know what are the incumbents going to do to you,  
15 and if you go to enough meetings where people describe  
16 what Microsoft might do to you or what other companies  
17 might do to you, a lot of the stuff we are talking about  
18 becomes irrelevant. Entry-deterrence is the problem.  
19 Will they cut prices? Yes, they might. Is that okay?  
20 Well, that's a tough one. That's very hard.

21 I know this sounds mushier than you'd like it to  
22 be. People who say I am going to measure costs and then  
23 I am going to measure market share -- in the Sirius/XM  
24 merger, right, they are going to take one data point and  
25 they are going to measure cross-elasticities and all



1 that other stuff? Ridiculous.

2 So, what I am saying is in a practical world in  
3 which new firms are being created, in which technology  
4 is increasingly important, in which small businesses and  
5 new entrants are the manufacturers of macroeconomic  
6 growth, I would lean pretty hard in the direction of  
7 being very skeptical about the range of competitive  
8 tools permitted to incumbents, to powerful incumbents,  
9 for macroeconomic reasons, for microeconomic reasons,  
10 and -- dare I say it, even though Judge Bork is a  
11 colleague of mine -- for equity reasons.

12 DR. WERDEN: Are you suggesting that if the  
13 incumbent is happily pricing at 100 and somebody has a  
14 new idea and comes in and sells it at 80 and the  
15 incumbent says, "Well, I better knock my price down to  
16 80 or I am not going to make any sales," he's already in  
17 trouble?

18 DR. STELZER: No, I am saying you have to look  
19 at a lot of things. You see, that's the trouble. You  
20 are trying to pick out one thing that will tell you what  
21 the hell is going on in this industry. You can't do  
22 that.

23 DR. WERDEN: Okay. Well, I concede that I can't  
24 do that. So, what do I do?

25 DR. STELZER: You look at the entire range of

1 business practices of the company. You look at the  
2 durability of its market share. You look at the history  
3 of the notices it has posted in the past when  
4 competitors try to come in, and you try to make a  
5 decision as to whether those were imposing  
6 inefficiencies on the potential competitors or not.

7 MR. WALES: Go ahead, Tom.

8 MR. KRATTENMAKER: I want to come to Irwin's  
9 partial defense now --

10 DR. STELZER: Oh, God.

11 MR. KRATTENMAKER: -- on Brooke Group but make a  
12 comment about -- to make a comment about what Joe said,  
13 too.

14 On what Irwin said, you know, pricing below  
15 cost, I am really not so sure. Recoupment, yes, and the  
16 short answer to your question, Greg, is you have got to  
17 show that they will be able to get their price back up.  
18 When we all sit around and decide that we have this  
19 common mantra and we decide to chant it, whatever this  
20 antitrust religion is that we have, you have to be  
21 careful to think about it once in a while.

22 Saying it has got to be below the pricing firm's  
23 cost is to smuggle in the old efficient competitor rule  
24 into the marketplace. If it is the case that the firm  
25 can by pricing right down to its cost drive out four

1 firms and leave us with one firm instead of five in a  
2 market, some people may say that drives us to more  
3 efficient production, and other people will say that is  
4 going to tend to drive prices further away from costs.  
5 It depends on which value you think is important in  
6 antitrust.

7 I think it would be better to have a discussion  
8 about that than the silly stuff in Brooke Group about  
9 what we happen to know because we happen to put on black  
10 robes and so we are infallible, that people often try  
11 predatory pricing and rarely succeed, a statement which  
12 I believe had no support. There might be a footnote  
13 there, but it doesn't cite any empirical work.

14 So, I don't mean to say that I am opposed to  
15 Brooke Group, but what I mean to say is you don't look  
16 askance at somebody and say, "You mean they wouldn't  
17 price below cost?" Irwin is talking about a somewhat  
18 different set of values and in this case a very  
19 defensible set of values, particularly if you do keep  
20 the recoupment link, I would say.

21 The other comment, I mean, I think this is the  
22 right time to make it, I thought Joe had one of the most  
23 interesting observations I've heard in a long time about  
24 the bright line rules and fact-based rules, and that's  
25 exactly what has happened to merger law in the whatever

1 years since Joe and I first started studying merger law,  
2 but it's not what's going on in section 2, and these are  
3 hearings about section 2.

4           You've got some cases that were sort of driven  
5 down to fact-based. Aspen Ski is one of those where  
6 they looked in the record and found that there were some  
7 angry skiers in Atlanta, and Kodak copiers is one of  
8 those, but we have some bright line cases, too,  
9 Weyerhaeuser, Brooke Group, the 11th Circuit decision in  
10 Schering-Plough, that say, do not tell me any facts.  
11 All I want to hear is some theory.

12           So, in section 2, we are in -- I'll shut up here  
13 now in a minute -- in section 2, we are at this funny  
14 point where we haven't moved to Joe's Nirvana, and I  
15 think we need to face that.

16           MR. SIMS: See, it is interesting. I agree with  
17 you on Brooke Group and Weyerhaeuser. Those are  
18 essentially safe harbor decisions.

19           MR. KRATTENMAKER: Yeah.

20           MR. SIMS: But I would vehemently disagree with  
21 you on Aspen Ski and Schering-Plough. I think that  
22 Aspen Ski is certainly not fact-based. You can't do a  
23 fact-based analysis of Aspen Ski and conclude that there  
24 was an antitrust violation there.

25           MR. KRATTENMAKER: No, the fact they found turns

1 out not to be a violation -- turns out not to be an  
2 anticompetitive act, but --

3 MR. SIMS: Well, that's certainly true, and I  
4 think Schering-Plough I think did focus on the facts,  
5 and the fact that was determined -- that was found to be  
6 determinative in Schering-Plough was the existence of  
7 the patent and the scope of that patent. That's a  
8 fact-based analysis to me, not rule-based.

9 DR. STELZER: Can I ask you something about  
10 Aspen Ski, because I am not a lawyer --

11 MR. SIMS: Sure.

12 DR. STELZER: -- although I was involved in that  
13 case just because I happened to be in Aspen at the time  
14 and the plaintiff couldn't afford anybody and I was  
15 free.

16 MR. SIMS: I remember actually visiting you in  
17 Aspen periodically.

18 DR. STELZER: Right. Well, come this summer,  
19 because I don't have judges setting my schedules  
20 anymore.

21 Let me ask you something. There was an  
22 unchallenged determination of the relevant market.

23 MR. SIMS: Yes, that was the --

24 DR. STELZER: Now, is that a fact or is that not  
25 a fact?

1           MR. SIMS: That was a lawyer error, actually.  
2 That was a stipulated market which any good antitrust  
3 lawyer wouldn't have done.

4           DR. STELZER: All right. So, we are now down  
5 to, if I understood it, it is not a fact if it is  
6 determined by a judge and a jury but it is a lawyering  
7 error. Is that right? So, that makes it not a fact.

8           MR. KRATTENMAKER: That's our position and we  
9 are sticking to it.

10          DR. STELZER: Okay, that's all right, I just  
11 wanted to know.

12          DR. WERDEN: Moving right along, Joe, I am not  
13 entirely sure I understand your position. I am not sure  
14 that you go so far as to say clarity is bad. I think  
15 your position more is that hoped for clarity isn't going  
16 to come in a useful way, to which my follow-up question  
17 is, well, aren't there things like the Brooke Group rule  
18 that would form conduct-based safe harbors that might be  
19 a good idea? For example, that it is okay to introduce  
20 a new product even if that causes your competitor to  
21 fail?

22          MR. SIMS: Well, I wouldn't have any problem  
23 with that rule, but I think you'd have a lot of trouble  
24 getting broad consensus on it.

25          DR. WERDEN: I am willing to try. Let's see

1 what we can do here on the panel.

2 MR. SIMS: You might find some people that think  
3 that's what Microsoft did and does and is doing --  
4 introducing new products that are creating competitive  
5 harms; at least I think that's the theory in the EU's  
6 current preoccupation with Microsoft. So, I am fine  
7 with a Brooke-type safe harbor for new product  
8 introductions. I am not exactly sure how you'd set it  
9 out so that you left it open for the one in a however  
10 many times that might be anticompetitive, but I'd be  
11 fine with that. I doubt seriously that you would get  
12 broad consensus on that.

13 My point is that there is not incredibly broad  
14 consensus on the Brooke Group rule, which is I think  
15 about the only effective safe harbor in section 2 now.  
16 So, I am not sure that you would have a very easy time  
17 coming up with consensus on any others. I am happy to  
18 see you try, and I could come up with a number that I'd  
19 be comfortable with, but I doubt that I'd get everybody  
20 to join with me.

21 DR. WERDEN: Well, we can give you 30 more  
22 seconds. How many can you give me in 30 seconds?

23 MR. SIMS: Well, new product design would be  
24 fine. I mean, in general, new products and product  
25 design decisions, I am involved now in defending Apple

1 in the iPod tying cases. We shouldn't have to go  
2 through all the hassle that we are going to have to go  
3 through to get rid of those cases. So, I am perfectly  
4 happy with that if you can find enough consensus to  
5 implement it.

6 DR. WERDEN: Do I hear any dissenters?

7 DR. STELZER: Well, I was just curious, Joe,  
8 what about what they call fighting brands in the  
9 cigarette industry?

10 MR. SIMS: What about them?

11 DR. STELZER: That's a new product.

12 MR. SIMS: Is there anything wrong with that?

13 DR. STELZER: Is there anything wrong with that?

14 MR. SIMS: No, I don't see anything wrong with  
15 that. Did it impair competition in some way?

16 DR. STELZER: It had very negative effects on  
17 some of the competitors who made the brands.

18 MR. SIMS: That's different.

19 DR. STELZER: But it sends a notice that you are  
20 going to come in --

21 MR. SIMS: Look, I happen to know an awful lot  
22 about the cigarette business, unfortunately, because I  
23 just did a merger there a couple years ago. There are  
24 one heck of a lot of independent sellers of cigarettes  
25 in the cigarette business. In fact, they have driven



1 the market share of the market leaders down, and more  
2 importantly, they have taken away a big part of their  
3 margin, which is why the FTC decided not to challenge  
4 the merger of the number two and number three players.

5 DR. STELZER: Okay.

6 MR. KRATTENMAKER: I worked on that case, too,  
7 and some of what Joe just said is true.

8 DR. WERDEN: Probably some of what Joe says is  
9 always true; it is a question of how much.

10 MR. KRATTENMAKER: I was on the other side, I'm  
11 sorry, I was doing it for the FTC.

12 MR. de la MANO: I would defend, Greg, that  
13 particular bright line rule.

14 DR. WERDEN: Okay. When is a new product  
15 introduction a bad thing for consumers?

16 MR. de la MANO: I think that's the wrong way to  
17 put the question. I think no bright line rule is going  
18 to work unless you define it very, very carefully, and  
19 you will --

20 DR. WERDEN: Of course. That's what your job  
21 is.

22 MR. de la MANO: Well, that's what we found in  
23 the new product rule that we were given by the court in  
24 the area of refusal to supply, the new product test,  
25 that -- it sounds fine in the context of that particular

1 case, I admit, but we just do not know what's a new  
2 product.

3 DR. WERDEN: Well, but if we are going to take a  
4 European approach to this question, then perhaps we  
5 should appeal to our ordoliberal traditions where, what  
6 we say in English, competition on the merits was a  
7 fundamental principle. That was legal without regard to  
8 its effect, and there are reasons to believe that this  
9 concept is embraced by Article 82.

10 Now, as far as I can tell, no European court has  
11 ever said that that actually means something, but it  
12 should mean something, shouldn't it?

13 MR. de la MANO: Definitely.

14 DR. WERDEN: Okay, what does it mean?

15 MR. de la MANO: Well, the problem is that if  
16 you put the question in terms of would a new product  
17 ever constitute the situation where it could lead to  
18 consumer harm, I think the answer is always going to be  
19 no. That is competition on the merits. That is a  
20 situation where there's going to be traditional value to  
21 consumers, that's pretty obvious, but the difficult  
22 thing for a competition agency is to define or identify  
23 whether that product is, indeed, new, and there are many  
24 situations where what might appear on the face of it to  
25 be a new product, from the perspective of certain

1 customers, but is just an extension or an additional  
2 feature that's added to an old product, but if that  
3 additional feature serves the purpose of preventing  
4 entry, then maybe there is a problem.

5 DR. WERDEN: I agree there's always going to be  
6 a fine line, and Irwin correctly pointed out that the  
7 fine line is Brooke Group is a serious problem. We  
8 can't figure out costs well. But that doesn't mean  
9 there's something fundamentally wrong with the  
10 principle.

11 MR. de la MANO: Absolutely not. It's not just  
12 a good bright line for enforcement.

13 DR. WERDEN: You are coming to that decision  
14 awfully fast. How long have you been applying it?

15 MR. de la MANO: I don't think we have had a  
16 single case in the IMS where we have actually been able  
17 to define a new product as of -- that's a few years.

18 DR. WERDEN: Of course, the bright line rule  
19 there is that you can refuse to license. That solves  
20 that problem, doesn't it?

21 MR. de la MANO: Yeah, solves that one, yeah.

22 DR. WERDEN: Okay.

23 MR. WALES: Should we move on to the principles?  
24 Go to the first one.

25 DR. WERDEN: Okay, I hope you people can see

1 this. We are going to read these.

2 MR. WALES: I actually have them in hard copies  
3 and we can pass them out.

4 DR. WERDEN: Okay. We are going to read them  
5 into the record in any event.

6 We have in most of our sessions, but not this  
7 morning, gone through what we call the propositions  
8 where we put up a declarative sentence and ask the  
9 panelists whether they agree or disagree and why.

10 The first one we have here is, "Monopoly power  
11 is the long-term ability of a firm to earn greater than  
12 a competitive return on investment."

13 It's not the most orthodox definition of  
14 monopoly power, but it happens to be the almost verbatim  
15 the definition in one of the leading economics  
16 textbooks, and it focuses attention on something that in  
17 principle we might be able to figure out, although it's  
18 not going to be easy, whether a firm is earning more  
19 than a competitive rate of return.

20 So, Tom, why don't you start.

21 MR. KRATTENMAKER: I think it is good enough for  
22 government work.

23 DR. WERDEN: Good enough for the courts of the  
24 United States of America?

25 MR. KRATTENMAKER: Not having tried to do a case

1 under this test, I would want to think some more about  
2 whether I'd rather be going and getting evidence about  
3 competitive returns than I would about prices and costs,  
4 Greg. So, I cannot answer your question. I am  
5 obviously -- as a lawyer, I am, of course, hind-bound, I  
6 am always looking backwards, and so I am happier with a  
7 test that focuses on price than competitive return if  
8 you give me 30 seconds to think about it, but --

9 DR. WERDEN: Well, that's fine. It doesn't say  
10 here what the evidence would be, and I think it would be  
11 prices and costs in some cases, most cases, but the  
12 question then is going to be, what price and what cost?

13 MR. KRATTENMAKER: Thank you for modifying this  
14 as we go. It has changed from long-term to long-run, it  
15 has changed from competitive return to pricing above  
16 costs. I think it is basically right, but I want to say  
17 the devil's in the details, but there are some details  
18 that would need to be worked out, but sure.

19 DR. STELZER: Would you accept --

20 MR. KRATTENMAKER: As you know, I'd also say  
21 that's also market power. I do not know, is that the  
22 next question? Do we have another question about that?

23 DR. STELZER: Can I ask you a question?

24 DR. WERDEN: Please.

25 DR. STELZER: Would you substitute cost of

1 capital for competitive return on investment?

2 DR. WERDEN: Possibly.

3 DR. STELZER: Okay. Have you ever been in a  
4 utility case where they're determining the cost of  
5 capital?

6 DR. WERDEN: We hardly ever do that anymore,  
7 thank God.

8 DR. STELZER: You hardly ever do it, but if you  
9 walk down the block, there's a lot of people doing it.  
10 There's economists doing it all the time and there's a  
11 huge dispute about it, but I think cost of capital is at  
12 least more precise as far as the literature goes than a  
13 competitive return on investment. So, if you want to  
14 play with this, I think you should do it in terms of  
15 cost of capital, because there are all sorts of ways of  
16 measuring cost of capital, and no one will know -- they  
17 won't know with as much precision what you are talking  
18 about when you talk about a competitive return.

19 DR. WERDEN: Well, coming back to Tom's  
20 question, if you want to put this in terms of prices and  
21 costs, the question, as I said, is what price and what  
22 cost?

23 MR. KRATTENMAKER: Sure.

24 DR. WERDEN: And in particular, the difference  
25 between monopoly power and market power, it is

1 conventional, at least, although there are some  
2 dissenters, to define market power as the ability to  
3 price above short-run marginal cost, but hardly anybody  
4 would say that the right definition of monopoly power is  
5 the ability to price above short-run marginal cost,  
6 because that would give us too many monopolists.

7 MR. KRATTENMAKER: I think your second sentence  
8 is correct and your first sentence is wrong.

9 DR. WERDEN: So, what is the definition of  
10 market power?

11 MR. KRATTENMAKER: I believe that market power  
12 has a durability component as well, the last time I read  
13 the Guidelines, nontransitory.

14 MR. WALES: So, shorter, Tom, is that the point?  
15 It is shorter than monopoly power?

16 MR. KRATTENMAKER: No, it is the same.

17 MR. WALES: So, both qualitative and  
18 quantitative? I guess you made the point that  
19 qualitatively, they're the same, but are they also  
20 quantitatively the same?

21 MR. KRATTENMAKER: Oh, I think each of them  
22 comes in degrees, Dave, I'm sorry. To go back to my  
23 metaphor -- they could turn out to be a one-point shot,  
24 a two-point shot, a three-point shot. I don't think it  
25 would serve us any value to say, well, if it is a

1 two-point shot, it is market power, and if it is a  
2 three-point shot, it is monopoly power. I don't -- as a  
3 matter of moving the cases along, I don't see the point.

4 DR. WERDEN: Well, let me put the question,  
5 then, doesn't it make sense to have a significant  
6 threshold in a section 2 case that is different and  
7 higher than the threshold of market power in a section 1  
8 case? And don't the cases pretty much say that's the  
9 law now?

10 MR. KRATTENMAKER: No. Yes.

11 DR. WERDEN: Okay, at least that was clear.

12 MR. BISHOP: But, I mean, the European  
13 perspective, I mean there is some debate in Europe about  
14 whether we can characterize firms which are dominant and  
15 those firms which are super-dominant, which is sort of,  
16 you know, similar to this, and my sense is that, you  
17 know, why bother introducing this new term, you know,  
18 "super-dominant"? If we are just going to use the  
19 dominance as a threshold step to deciding whether we  
20 need to investigate in more detail the competitive  
21 conduct, whether a firm is dominant or super-dominant  
22 doesn't really make any difference in that decision.

23 DR. WERDEN: Okay, let's move to the second  
24 proposition. I think Joe spoke precisely these words,  
25 and I want to see how much consensus we have on the



1 proposition that monopoly power is rare.

2 MR. WALES: If we can go back to Miguel.

3 MR. de la MANO: Well, in line with any  
4 consensus that monopoly -- it makes very little sense to  
5 distinguish between market power and monopoly power for  
6 the reasons that have been explained on both sides of  
7 where I am sitting, I would say monopoly power is fairly  
8 common. The key question is, however, how much of it do  
9 you really need to show or need to have before you  
10 decide to investigate any further? Being shown monopoly  
11 power is not anything in itself; it is the practice  
12 itself, the conduct.

13 DR. WERDEN: I think you have identified one of  
14 the major differences in attitude between the European  
15 school and ours. Our courts are really hard sells on  
16 the subject of monopoly power. It is an empirical fact  
17 that it is very hard to convince a court that a firm has  
18 a monopoly in the United States, and it's not that hard,  
19 it seems, in Europe.

20 I think you have already cast your vote that it  
21 is probably too hard in the United States. Anybody else  
22 want to weigh in on that?

23 MR. KRATTENMAKER: Well, yeah. I mean, I think  
24 that Miguel has really laid his finger on it. If we  
25 then say that you possess market or monopoly power if

1 you face a downward-sloping demand curve, I think it may  
2 well be that many, perhaps most firms, do, but the  
3 second thing I was going to say is this question,  
4 monopoly power is rare, is exactly why I went to law  
5 school instead of graduate school in economics. You  
6 have to ask an economist who does not I/O theory, but  
7 I/O reality, how often this happens. Isn't this what  
8 Joe Bain spent his life trying to do, but --

9 DR. WERDEN: I don't think so, but --

10 MR. KRATTENMAKER: Okay.

11 DR. WERDEN: Anyone else?

12 MR. de la MANO: Can I reverse the question?

13 DR. WERDEN: Rare is power monopoly?

14 MR. de la MANO: No. Do you think  
15 contestability of a market is rare?

16 DR. WERDEN: I think it is unheard of.

17 MR. de la MANO: Well, there you go.

18 DR. WERDEN: I am not sure where I am.

19 MR. BISHOP: How does that follow?

20 MR. de la MANO: Well, it follows that if  
21 contestability is the opposite of monopoly power and  
22 contestability is unheard of, it must be because most  
23 firms have market power.

24 DR. WERDEN: Well, but then you are equating  
25 market and monopoly power, and I am not buying into that

1 one.

2 MR. de la MANO: Okay.

3 MR. BISHOP: And I guess it also relates to  
4 entry to a market. You can have firms with high market  
5 shares subject to effective competitive constraints  
6 because the small rivals could easily expand.

7 DR. WERDEN: Okay, a third proposition, and this  
8 is something that Simon already said. "The Cellophane  
9 fallacy likely does not apply in attempt to monopolize  
10 cases." Of course, he didn't use that language, because  
11 that's American language, but here we have an offense of  
12 attempt to monopolize in which the defendant doesn't  
13 start out dominant, but it is alleged that he would end  
14 up dominant with a dangerous probability through the  
15 activities that he's engaged in, and in defining the  
16 market in such a case, the proposition is that the  
17 Cellophane fallacy probably isn't a problem.

18 Simon I think already said yes, that's true. Do  
19 we have any other views?

20 MR. BISHOP: Easy one.

21 DR. WERDEN: I think that's an easy one. I like  
22 easy ones.

23 Next, "When the Cellophane fallacy does apply,  
24 which is not a significant number of cases, the proper  
25 benchmark price in market delineation is the market

1 price absent the challenged conduct, which is normally  
2 not the competitive price."

3           It is often said, perhaps rashly and wrongly --  
4 we are going to find out -- that you should go down to  
5 the competitive price to do the market definition  
6 analysis. This proposition says no, you should look at  
7 some kind of but-for price, and Simon, what do you think  
8 about that?

9           MR. BISHOP: Interesting theoretical question.  
10 The answer is sort of, maybe, but I think in the sort of  
11 practical reality, it makes no difference. You don't  
12 know what the but-for price is; you don't know what the  
13 competitive price is.

14           DR. WERDEN: As a practical matter, you may be  
15 exactly right, but let us suppose you could actually  
16 figure these things out. What would you do?

17           DR. STELZER: And if my grandmother had wheels,  
18 she'd be a bus.

19           MR. BISHOP: If you think about these things,  
20 then all we need to do is be concerned with the  
21 Cellophane fallacy or anything. The whole antitrust  
22 would be very, very easy.

23           MR. SIMS: And that is how we get ourselves into  
24 the messes that we get ourselves into, is pretending  
25 that we can ignore reality.

1           MR. KRATTENMAKER: I think this is a very  
2 interesting concept, and it might be right, but I didn't  
3 understand the earlier question, and I don't mean this  
4 as a challenge, Greg, but if you -- if we know both the  
5 market price absent the challenged conduct and we also  
6 know the competitive price?

7           DR. WERDEN: Yes.

8           MR. KRATTENMAKER: And you are making two  
9 statements, which is that those are normally  
10 different --

11          DR. STELZER: Right, and then which is the  
12 benchmark?

13          MR. KRATTENMAKER: And then I would choose one?

14          DR. WERDEN: Yeah. I am not saying these things  
15 are easy to figure out. They are not. I agree with  
16 Simon.

17          DR. STELZER: They are impossible. It's not  
18 that they are not easy.

19          MR. KRATTENMAKER: I am only clarifying the  
20 question. The question assumes that I know these two  
21 prices that are in here, and so you are asking -- you  
22 are making a statement and asking us about a statement  
23 and a value choice.

24          DR. WERDEN: I'll let you know everything that  
25 you'd like to know.

1           MR. KRATTENMAKER: Okay, I know the market price  
2 absent the challenged conduct, and I know the  
3 competitive price, and I know that the market price  
4 absent the challenged conduct is higher than the  
5 competitive price.

6           DR. WERDEN: Yes.

7           MR. KRATTENMAKER: Simon's the expert, but I'd  
8 be inclined to say that the right answer whatever the  
9 empirical fact is, that the right answer is you focus  
10 not on the price absent the challenged conduct but on  
11 the competitive price, but I thought his basic answer  
12 was correct --

13          DR. WERDEN: Why?

14          MR. KRATTENMAKER: -- which is, you know, I do  
15 not know either better than the other.

16          DR. WERDEN: I don't want you to give an answer  
17 now. I want to know why.

18          MR. KRATTENMAKER: Because that is what we are  
19 more likely to be able to assess the supply and demand  
20 responses to, that --

21          MR. BISHOP: But doesn't --

22          MR. KRATTENMAKER: -- as the market definition  
23 process asks us to do.

24          MR. BISHOP: But this comes down to, I mean,  
25 there's practically no difference. I mean, if you knew

1 what the competitive price was in every single industry,  
2 antitrust policy would be extremely easy, just go around  
3 and tell firms that you are not allowed to price more  
4 than the competitive price.

5 MR. de la MANO: I wouldn't be so drastic on  
6 that, Simon. I think the question has merit. I do not  
7 know what the theoretical answer to this is, but I think  
8 from a practical standpoint, I actually think it could  
9 be easier in some cases to assess what the price would  
10 be in the absence of the conduct given that we are very  
11 unlikely to see, going back in time, a market which is  
12 currently not competitive that might have been  
13 competitive in the past, but it is very likely to see a  
14 situation that a few years ago, a market being a  
15 monopoly was one where that conduct was absent, and it  
16 might be possible to compare or even do some natural  
17 experiments across regions, even contemporaneously, to  
18 compare what is the precise situation where the conduct  
19 is absent. So, this theoretical conversation, were it  
20 to be valid, I think in practice, it could be very  
21 useful.

22 MR. BISHOP: Well, I still think that, you know,  
23 either benchmark means that the inferences that you can  
24 draw from, you know, the available data is similar to  
25 the same issues, whether it is a competitive price or a

1 price absent the conduct. Just seriously, from a  
2 practical point of view, I do not think it makes any  
3 difference at all. We can have a, you know, good, you  
4 know, theoretical debate in saying which one is the  
5 appropriate one, but from a practical point of view, I  
6 do not think there is any difference whatsoever.

7 DR. WERDEN: We have pretty much covered this  
8 one, but we are going to put it up anyway, see if  
9 anybody has anything more to add.

10 "A market-share based safe harbor is appropriate  
11 in monopoly cases."

12 MR. BISHOP: Yes.

13 DR. WERDEN: Okay, we have one yes.

14 MR. de la MANO: Two.

15 MR. SIMS: What's the number?

16 DR. WERDEN: That's the next slide.

17 MR. SIMS: I can't answer it without the number.

18 DR. WERDEN: Pick your own number.

19 MR. KRATTENMAKER: I say no to this sentence  
20 because it has a singular noun.

21 MR. SIMS: If you give me -- if you give me a,  
22 you know, 70 percent or an 80 percent number, I might be  
23 very comfortable with that.

24 DR. WERDEN: Okay, we have got a vote for 70 or  
25 80 percent. We might not have unanimity on 70 or 80



1 percent.

2 DR. STELZER: What is it appropriate to? If it  
3 is appropriate as a general prosecutorial guide for guys  
4 picking cases to bring, along with the feasibility of  
5 relief, then it might be useful, but --

6 DR. WERDEN: If it is a safe harbor, it is a  
7 rule that courts are going to use on summary judgment to  
8 kick out cases.

9 DR. STELZER: Then I would say no.

10 MR. SIMS: And I know Tom says no. He has to  
11 say no.

12 MR. KRATTENMAKER: Yes, I did. I already said  
13 no. I would say yes, it might make sense to have one  
14 safe harbor --

15 DR. WERDEN: You're saying yes, but you're  
16 coming in with a low number, right, 25?

17 MR. de la MANO: I find it hard to understand  
18 this myth, which I alluded to before, that in Europe we  
19 have a serious concern with type II errors, yet when it  
20 comes to using market share safe harbors, there is  
21 consensus here on this side of the table that they can  
22 be used. Isn't that a sign that you want to leave open  
23 the possibility to bring any type of case, irrespective  
24 of market shares being rather low?

25 MR. SIMS: Well, no, that's not my reason at

1 least. My reason for being nervous about safe harbors  
2 unless they're very high is the concern that the safe  
3 harbor set too low will end up with serious  
4 over-enforcement above that number.

5 MR. BISHOP: Okay, but this comes back to the  
6 sort of philosophical or institutional, philosophical  
7 differences between the EU and the U.S., because  
8 personally, I would set the threshold at 70-80 percent,  
9 but I'd much prefer in the EU to have one of 40 percent  
10 than to have no threshold at all.

11 MR. SIMS: Okay, and that's a fair point given  
12 the regulatory environment that you find yourself in.

13 MR. WALES: I guess one question I had, Tom, is  
14 I thought I had read where you talked about the  
15 possibility of having different thresholds perhaps for  
16 different types of -- your two types of conduct. You  
17 had the conduct where someone acts to reduce output on  
18 their own as opposed to acting to exclude rivals, and I  
19 guess you kind of left open the proposition I thought  
20 that perhaps you might be willing to look for markets  
21 with the former and not the latter.

22 MR. KRATTENMAKER: No, I might be willing to  
23 look for one for each. That's why I said, my objection  
24 to this is that it -- that the noun is singular.

25 DR. WERDEN: Do you have some numbers in mind?

1           MR. KRATTENMAKER: Do I have numbers in mind?  
2       No, but I think you might well be able to come up with  
3       market share based safe harbor for exclusionary conduct  
4       section 2 cases.

5           MR. WALES: I have a question for --

6           MR. KRATTENMAKER: But it wouldn't, in my view,  
7       be an appropriate -- it wouldn't be the same threshold  
8       that would be appropriate for collusion-based section 2  
9       type cases, which are generally rare but still can be  
10      out there.

11          MR. WALES: A quick question for Miguel, I guess  
12      where does 40 come from in terms of setting the  
13      threshold level in the European Commission?

14          MR. de la MANO: Well, as far as I know, it is  
15      from a case, but, I mean, I think the thing is -- I  
16      think the discussion is also highlighting this -- there  
17      is a question as to, you know, what is the threshold  
18      going to be used for? If you believe that once you are  
19      above the threshold, basically the case has been proven,  
20      then clearly you want to have as high a threshold as  
21      possible.

22          If, on the other hand, you believe as I do, at  
23      least, that the threshold is just the first step, just  
24      the screen to sort of ditch the cases which are  
25      obviously not a problem, if you have sufficient

1 discipline imposed upon yourself as a competition  
2 authority in what you need to prove further, there is no  
3 problem in having a low threshold. In fact, it is  
4 probably better to have a low threshold, because that  
5 makes the assessment of your facts credible.

6           Otherwise, if you have a threshold at a sort of  
7 middle level, such as 40 or 50 percent, there is always  
8 going to be a group of people who think, a-ha, okay, so  
9 this discipline you say you have, that you are going to  
10 go after -- assessing the effects afterwards, after  
11 showing dominance, it is not really true, because as  
12 soon as you are above 50, it is really easy to assess  
13 the facts, and therefore, there is no credibility to the  
14 second discipline, as it were.

15           MR. BISHOP: Okay, but I would take a different  
16 view, and sort of just to be clear here, when I said  
17 that dominance in Europe is then inferred to be an abuse  
18 of, you know, of that market power, that's not my  
19 position. That's the position of the European courts,  
20 that most of the issues we are talking about here are  
21 exclusionary, and the courts have held that any harm to  
22 a competitor necessarily leads to harm to competition,  
23 and therefore, given that sort of standard by the  
24 European courts, there is no room, really, for an  
25 effects-based system.

1           So, as you lower the threshold from 40 percent  
2           to 25 percent, it makes things much worse in Europe  
3           unless the Commission is going to be very clear that  
4           they are going to take on the courts and that court  
5           reasoning, that you can infer harm to competitors  
6           necessarily translates to harms to competition, that,  
7           you know, the Commission is going to take that square  
8           on, because if they do not, any lowering away from the  
9           40 percent to just come out of case law is just going to  
10          make things worse.

11           MR. de la MANO: The court has already told us a  
12          few months ago that it is willing to reconsider its  
13          previous positions on this matter, and in the Glaxo  
14          decision -- and actually, it is actually an area of  
15          Article 81, cartels or agreements, but it has made it  
16          very clear that it is very open and willing to see a  
17          more effects-based analysis on the part of the  
18          Commission both in the area of assessing possible harm  
19          to consumers, but also in the area of assessing  
20          efficiencies. So, I think the courts are open to be  
21          challenged by the Commission on this point.

22           MR. BISHOP: Well, I would just say, you know,  
23          let's wait and see, stick with 40 percent and then see  
24          how they move before lowering the threshold.

25           MR. WALES: Let's go to the next one.

1 DR. WERDEN: Skip the next one and go one  
2 further.

3 MR. KRATTENMAKER: Can we mail in our answers to  
4 the one, number seven?

5 DR. WERDEN: If you like. It is about  
6 econometrics. Did you want to handle it, Tom?

7 MR. KRATTENMAKER: Of course. I mean, that's  
8 the most fun, is talking about something that we do not  
9 know. I thought it was a really interesting and  
10 provocative question. I think it is largely correct,  
11 but I would have some comments on it, but go ahead.

12 DR. WERDEN: We are nearing our end point.

13 MR. KRATTENMAKER: No, go ahead.

14 DR. WERDEN: As our end point, we are going to  
15 take this last proposition from the Syufy case, one of  
16 our failures in court.

17 "In evaluating monopoly power, it is not market  
18 share that counts, but the ability to maintain market  
19 share."

20 MR. KRATTENMAKER: Could there be anything more  
21 incorrect?

22 DR. WERDEN: I imagine that there could, but let  
23 me just add that I think what the quote is trying to say  
24 is the point that Joe made several times, which is  
25 durability is crucial in monopoly power.

1 MR. KRATTENMAKER: I see, okay.

2 DR. WERDEN: And monopoly power requires much  
3 more durable power over price than market power does.

4 MR. KRATTENMAKER: Gotcha.

5 MR. SIMS: When I read this, my answer was, I do  
6 not know exactly what these words mean --

7 MR. KRATTENMAKER: Okay.

8 MR. SIMS: -- but if they mean durable market  
9 power, then --

10 MR. KRATTENMAKER: If they mean entry barriers  
11 and -- okay, you are saying they're importing it, okay.

12 DR. STELZER: As a practical problem with that,  
13 it is an easy matter in any case to find someone who  
14 will tell you why whatever monopoly power or market  
15 power you see is not durable. I have had people tell me  
16 that monopoly power in the transmission of electricity  
17 is not durable because they have some innovation in  
18 mind.

19 In other words, you can fill the courtroom with  
20 experts who will tell you why market power that has  
21 persisted for 150 years is really not durable given some  
22 new technology or given some new something, but --

23 DR. WERDEN: But they're wrong, aren't they?  
24 But you are saying that they're wrong?

25 DR. STELZER: They're wrong.

1 DR. WERDEN: Okay.

2 DR. STELZER: So I would be very careful about  
3 introducing a test that says not only do you have to  
4 have market power, but it has to be proved to be durable  
5 in order to create a problem, because that's an  
6 impossible test to meet.

7 MR. SIMS: It is true, and I think everybody  
8 should admit that it is true, that the more you get away  
9 from slogans and general rhetorical concepts and the  
10 closer you get to careful analysis of the facts, the  
11 less enforcement you are going to have, because it is  
12 harder. It is harder for plaintiffs, whether they're  
13 the Government or private plaintiffs, to prove a case if  
14 they have to slog their way through the facts.

15 That's why the per se rule is so attractive to  
16 plaintiffs' lawyers in damage cases, because they do not  
17 have to prove anything. So, you know, that's an  
18 inevitable result of being more wedded to factual  
19 analysis than setting up bright-line rules. I don't  
20 think it is a reason not to do it, but it is a result  
21 that we ought to be -- that we ought to recognize and  
22 accept.

23 MR. WALES: Anybody else?

24 DR. WERDEN: Well, we are a few minutes past our  
25 official end time, so why don't we wrap it up and take



1 one last opportunity to thank our panelists.

2 (Applause.)

3 MR. WALES: Thank you very much. I guess we are  
4 adjourned.

5 (Whereupon, at 4:34 p.m., the hearing was  
6 adjourned.)

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## 1 C E R T I F I C A T I O N O F R E P O R T E R

2 DOCKET/FILE NUMBER: P062106

3 CASE TITLE: SECTION 2 HEARING

4 DATE: MARCH 7, 2007

5

6 I HEREBY CERTIFY that the transcript contained  
7 herein is a full and accurate transcript of the notes  
8 taken by me at the hearing on the above cause before the  
9 FEDERAL TRADE COMMISSION to the best of my knowledge and  
10 belief.

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DATED: 3/12/2007

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SUSANNE BERGLING, RMR-CLR

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## 18 C E R T I F I C A T I O N O F P R O O F R E A D E R

19

20 I HEREBY CERTIFY that I proofread the transcript  
21 for accuracy in spelling, hyphenation, punctuation and  
22 format.

23

24

25

DIANE QUADE