

Section 5 as a Bridge Toward Convergence

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Creative thinking about Section 5 of the Federal Trade Commission Act should take into account the need for building bridges toward harmonized antitrust enforcement on an international scale. In this article, I point out several opportunities for convergence that are open to the FTC, including commonalities in Europe's abuse of dominance standard and the FTC's unfairness standard (providing examples relating to unilateral withdrawal of capacity and abuse of buying power); and guidance for determining when resale price maintenance and price discrimination are either pro- or anticompetitive.

The Federal Trade Commission Should Use Section 5 as a Bridge Toward Convergence with Europe.

Our interest in this discussion is in practical applications of Section 5 that go beyond the other antitrust laws. The context for the ideas I will raise is international. One of the primary missions of the antitrust enterprise in the coming years must be to move toward a system of enforcement that has coherence and practical workability on a global playing field. I will focus on some ways in which Section 5, with its particular potential for prospective clarification of the law, can be used to bridge gaps with the European Union and other civil law jurisdictions.

This context is important because there are now more than one hundred nations with their own antitrust laws and there is no overarching institution for formally harmonizing these laws or for resolving disputes involving cross-border transactions and/or behavior. With the relatively recent breakdown of Doha Round efforts toward convergence, it will be up to the leading antitrust jurisdictions, i.e., the United States and the European Union—one a common law jurisdiction, the other civil law, each with its own traditions and needs—to try to bring as much harmony as possible to the antitrust world. This can be achieved to an important extent through the tools of guidance that are familiar to both the FTC and the European Commission.

As we head into a global economic recession, we can predict that pressures will build to limit trade, to promote protectionistic policies, and to reverse the positive momentum that has characterized international competition policy in so many ways since the late 1970s and early 1980s when the principal international issue was the extent of our extraterritorial reach and I was head of an FTC task force looking into allegations that our antitrust laws had become an obstacle to a strong U.S. presence in an increasingly global economy.¹ (We concluded, incidentally, that the charges were mostly wrong but that there were adjustments that the Commission should consider in light of increasing cross-border trade.) I believe that if the United States and the European

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¹ See Albert A. Foer, *International Implications of Section 7 Enforcement*, 50 ANTITRUST L.J. 819 (1981).

Union can now work together to formulate and present more of their competition policies in a common language, they together will have a better chance of achieving what I take to be their common goal of strengthening the role of antitrust enforcement throughout the world.

At the current time (i.e., at the end of the Bush era), it seems to me that, philosophically, the FTC is considerably closer to Rue Joseph II in Brussels than to its neighbor on 10th and Pennsylvania. Although there are undeniable complexities if the FTC stakes out positions too different from those of the Department of Justice, I believe that the two institutions are intended to be different and that Section 5 and the processes that permit its interpretation to evolve make it and the Commission a better candidate than the Sherman Act and the DOJ for attempting to bridge the gap between European and American competition policies. The DOJ's ideological constraints will likely be loosened in the future. In the meanwhile, I urge the FTC, while consulting with DOJ, to take the initiative in seeking modes of convergence with the European Commission.

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Section 5 and Article 82 Have Similarities that Can Be Emphasized Through Various Mechanisms of Guidance that Will Give Common Structure to Their Inherently Vague Meanings.

Let us begin by recognizing a few important similarities between Section 5 and Article 82 of the Treaty of Rome. One deals with “unfair” methods of competition, the other with “abuse” of a dominant position. Both “unfair” and “abuse” are open-ended words that are normative in nature, certainly not restricted to a narrow efficiency-based meaning. They should be viewed as quite similar. What is not unfair is not abusive; what is not abusive is not unfair. Or so the words could be defined. Both of these tests of commercially incorrect behavior are fundamentally vague as stated and require structure in order to avoid their arbitrary and unpredictable application. It is in the common interest of the European Union and the United States to find the areas in which they can express their interpretations of Section 5 and Article 82 with similar guiding language.

Both concepts deal with monopoly power in the sense that they are understood to apply to firms with very high market shares. But market power can be exercised unfairly or abusively with anti-competitive effects in certain situations without having monopoly levels of market share. Whereas the Sherman Act clearly applies to firms that have the status of economic monopoly, Article 82 clearly applies to lesser levels of market power in which a firm has achieved dominance.²

I believe that Section 5 can and should be applied with a realistic and practical assessment of a firm's ability and incentives to exercise market power and its effects, and that a firm which is dominant in actuality and which engages in an unfair method of competition should be reachable under Section 5 even if its market share is less than the “70 percent or so” that often characterizes Sherman Act decisions.³ The concept held in common is, or could be, that when a firm has

² EINER ELHAUGE & DAMIEN GERADIN, *GLOBAL ANTITRUST LAW AND ECONOMICS* 268 (2007); ANDREW I. GAVIL ET AL., *ANTITRUST LAW IN PERSPECTIVE* 676 (2002) (“EC policy and jurisprudence tend to define dominance as occurring at market share thresholds of 40 to 50 percent—considerably lower than the 70 percent or so that American courts usually associate with monopoly power in Section 2 cases.”).

³ The U.S. Supreme Court has indicated that market shares above 66 percent indicate monopoly power without clearly specifying the lower boundary. *See United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 379 (1956). The EC's recently released guidance document on how it intends to interpret Article 82 indicates that dominance will generally not be found where the market share is less than 40 percent. *See Commission of the European Communities, Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings III A. 14* (Dec. 3, 2008, available at <http://ec.europa.eu/competition/antitrust/art82/guidance.pdf>) [hereinafter *Guidance*].

so much power over its market that it is capable of undermining a competitive market by unilateral actions, it can be held liable for abusing that power.⁴

In December 2008, the European Commission issued a detailed guidance document on its interpretation of Article 82 that provides a basis for careful comparisons.⁵ Hopefully, the FTC will be able to work jointly with the Commission or at least with the EC's approach in mind, to provide comparable, if not identical guidance, through adjudicated cases, speeches, guidelines, formal rules, and other forms of guidance, which can be directed at specific categories of abuse.

In this way, the FTC can help bridge a gap that has probably been exaggerated in the past, when a small proportion of high profile cases were decided in different ways by the DOJ and the European Commission. In recent years, as the European Commission has moved in the direction of more and better use of economic science and a new emphasis on the importance of effects rather than structure, and as the FTC has developed its own jurisprudence that does not always go in lock step with the DOJ,⁶ the potential convergence between the FTC and the EC has become a reachable and desirable objective. I do not mean to imply by this that the FTC can ignore the DOJ or act as if it were a sovereign and I do not mean to suggest that the FTC should take its marching orders from Europe; rather, I am suggesting that as the FTC gives renewed consideration to the meaning of Section 5, it should keep in mind that there are potential benefits in taking European learning and experience into account and in seeking ways to bring the two antitrust jurisdictions closer together through processes of formalized guidance.

“Unilateral Withholding” Is an Example of a Section 5 Violation that Does Not Necessarily Violate the Sherman Act, but Which Can Be Viewed as an Abuse of Dominance.

We have seen circumstances in the electricity industry, most strikingly in California, where an electric generator has been able to produce significant increases in price by strategically reducing its output, for example by closing a plant for maintenance at a time of peak demand when the indus-

⁴ Early case law in the European Union “seems quite parallel to the U.S. formulation of a power to exclude competition or control prices, and raises similar issues.” ELHAUGE & GERADIN, *supra* note 2, at 267. The new Guidance from the European Commission states, “Dominance has been defined under EC law as a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on a relevant market, by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers.” *Guidance*, *supra* note 3, at III A.10. Although this is more encompassing than the Sherman Act, it could arguably be adopted by the FTC as a reasonable interpretation of Section 5.

⁵ The United States has no such document, although the DOJ/FTC Horizontal Merger Guidelines reflects a similar approach to spell out how a major section of the antitrust law is to be interpreted. *See generally* U.S. Dep’t of Justice & Federal Trade Comm’n, Horizontal Merger Guidelines (1992, revised 1997), available at <http://www.ftc.gov/bc/docs/horizmer.htm>. Such guidelines are more typical of a civil law than a common law approach, and indicate a potential pathway for convergence. In a recent report, the Antitrust Division did seem to attempt to pre-empt the European Commission, but its narrow interpretation was rejected by the Federal Trade Commission and its future influence is dubious. *See generally* U.S. Dep’t of Justice, Competition and Monopoly: Single-Firm Conduct Under Section 2 (2008), available at <http://www.usdoj.gov/atr/public/reports/236681.htm>. *But see* Press Release, Fed. Trade Comm’n, FTC Commissioners React to Department of Justice Report, Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act (Sept. 8, 2008), available at <http://www.ftc.gov/opa/2008/09/section2.shtm>.

⁶ I applaud the Commission for not allowing the DOJ’s recent statement on Section 2 to stand unchallenged as an expression of the Section 5’s approach to unilateral conduct. *See generally* Statement of Commissioners Harbour, Leibowitz, and Rosch on the Issuance of the Section 2 Report by the Department of Justice (Sept. 8, 2008), available at <http://www.ftc.gov/os/2008/09/080908section2stmt.pdf>; Statement of Federal Trade Commission Chairman William E. Kovacic, Modern U.S. Competition Law and the Treatment of Dominant Firms: Comments on the Department of Justice and Federal Trade Commission Proceedings Relating to Section 2 of the Sherman Act (Sept. 8, 2008), available at <http://www.ftc.gov/os/2008/09/080908section2stmtkovacic.pdf>. However, the DOJ’s publication suggests the desirability of an FTC statement providing guidance on its interpretation of Section 5.

try is operating close to full capacity.⁷ A successful withholding strategy appears to require highly inelastic demand on the part of consumers and a temporary situation that can be exploited by a strategically situated, but not necessarily monopolistic, firm.

Strategic unilateral withholding by a non-monopolist would arguably violate Section 5, but perhaps not the Sherman Act, if the following elements are present:

- a. There is highly inelastic demand at a time of peak capacity utilization;
- b. Strategic temporary withholding is not justified by a legitimate business practice;⁸
- c. Such withholding undermines efficiency in the market;⁹
- d. It is unfair in the sense that it is opportunistic or coercive. For example, there may be a legitimate expectation by customers that electricity production will not be slashed in an arbitrary way during peak demand when they have no alternatives or even the knowledge of what their supplier is doing.

The electricity example occurs in the context of a regulated sector. This fact would not deprive the FTC of regulatory authority, which is shared with the Federal Energy Regulatory Commission under the Federal Power Act.¹⁰

Would there be a remedy the FTC could employ against unilateral withholding?¹¹ Most likely the Commission would not act in the electricity context in the absence of a pattern of repeated behavior. A possible remedy could be to enjoin the behavior and require a demonstration of legitimacy prior to future withholdings of a defined nature. In the PacifiCorp merger,¹² for example, the remedy was divestiture to avoid the possibility of withholding.

Certainly, there could be a Section 5 unilateral withholding example in an unregulated industry. Consider the possibility of a manufacturer of flu vaccine closing one of its plants during flu season for the purpose of creating an artificial shortage.¹³ Assume there are three manufacturers of this vaccine, each with multiple plants, and that no firm has more than 35 percent of the market. Assume further that no new entry is possible during the current flu season.

But wouldn't a firm necessarily have Section 2 monopoly power to enable it successfully to withhold output and raise prices? In the case of electricity, this may be a matter of market definition. If the market is defined very narrowly and in terms of a time period that may be measured in minutes or hours, perhaps one can build a case for the temporary but repeated exercise of monop-

⁷ See Diana L. Moss, *Electricity and Market Power: Current Issues for Restructuring Markets (A Survey)*, 1 ENVIRONS: ENVTL. & ENERGY L. & POL'Y J. 11, 18 (2006) (calling withholding "a relatively novel form of market power in an industry that has traditionally been concerned with exclusionary conduct."). It has been shown that market power can be exercised not only during peak periods but during off-peak and shoulder periods too. A recent merger complaint by the DOJ alleges that the potential of withholding capacity would be among the reasons the merger would have been illegal. Complaint, *United States v. Exelon Corp.*, No. 1:06CV01138 (D.D.C. filed June 22, 2006), available at <http://www.usdoj.gov/atr/cases/f216700/216785.htm>.

⁸ A legitimate business practice would be, e.g., to close for scheduled or emergency repairs.

⁹ A resulting price increase would be evidence of an anticompetitive effect.

¹⁰ That the Federal Power Act does not remove the electric industry from antitrust oversight was made clear in *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973).

¹¹ For an example of an FTC case involving withholding, see Analysis of Proposed Consent Order to Aid Public Comment, PacifiCorp, FTC File No. 971-0091 (Feb. 18, 1998), available at <http://www.ftc.gov/os/1998/02/9710091.ana.htm>. The analysis shows how withholding for a short period by a vertically integrated energy company can result in a price hike.

¹² *Id.*

¹³ See Albert A. Foer et al., *What Do Exit Polls and Flu Vaccine Shortages Have in Common?*, FTC:WATCH No. 647, Feb. 14, 2005, at 12, available at <http://www.antitrustinstitute.org/Archives/379.ashx>.

oly power. But it is not clear that the Sherman Act can or will be stretched in this manner, whereas Section 5 can focus on the effects and use it to imply the pre-event market power.¹⁴

In the case of the flu vaccine, if all available vaccine is being demanded at the height of flu season and all plants are operating at capacity, even a manufacturer with a relatively low share of the market could unilaterally close one of its plants, perhaps temporarily, be able to raise its own prices in the face of inelastic demand and reduced supply, and benefit (along with its rivals) from the higher price, provided the higher price on a lower output is expected, on balance, to increase profitability for the firm. The remedy here would be a mandatory injunction to resume production of the vaccine.¹⁵

Thus, unilateral withholding may be an example of a non-monopolist dominant firm, perhaps defined with respect to the price sensitivity of the residual demand it faces, abusing its position of power and engaging in an unfair method of competition. Both the FTC and the European Commission could likely agree on a statement to this effect.

Abuse of “Buyer Power” May Violate Section 5 Without Monopsony-Level Market Power

A second example of a dominant but not monopolistic firm engaging in an unfair method of competition could be found in the area of buyer power. For a variety of reasons, a power buyer can exercise disproportionate, anticompetitive bargaining power over its suppliers when it has a market share far below that required for a monopolistic seller.¹⁶ The American Antitrust Institute (AAI) points to the emergence of large buyers as a prominent feature in many sectors of the economy¹⁷ and defines buyer power as “the ability of a buyer to depress the price it pays a supplier or to induce a supplier to provide more favorable nonprice terms.”¹⁸ This encompasses both classic monopsony and what the AAI refers to as “countervailing power.” Both monopsony and countervailing power can have competitive effects that are beneficial or harmful, which means that outside of the buyer cartel context they need to be assessed under the rule of reason. Monopsony and countervailing power differ in the degree of dominance required to exercise market power:

Since classic monopsony power is the mirror image of monopoly power—a large degree of market power—classic monopsony power is normally associated with a large share of purchases in the relevant market, approximately 70% or more. In contrast, both theory and evidence suggest that a firm can exercise countervailing power in many market settings with a substantial but nondominant share, perhaps as little as 10–20%. Countervailing power, therefore, is likely to be exercised more frequently than

¹⁴ In this, one might argue that the Section 5 violation is of a nature that the Sherman Act, properly construed, could reach it, but I tend to think it is enough of a stretch that the justification for FTC action should not have to rest on making a prediction of this sort.

¹⁵ Compare this hypothetical with the FTC’s action in the *Stone Container* case. Analysis of Proposed Consent Order to Aid Public Comment, Stone Container Corporation, FTC File No. 951-0006 (Feb. 25, 1998), available at <http://www.ftc.gov/os/1998/02/9510006.ana.htm>. In that case, the respondent, apparently not a monopolist and facing excess capacity in the industry, unilaterally closed several of its plants while acquiring its competitors’ inventory, with the intent of encouraging competitors to raise prices. This was treated as an invitation to collude, in violation of Section 5. In my hypothetical, the problem is not excess capacity and there is no need for competitors to follow suit in order for prices to increase.

¹⁶ See AM. ANTITRUST INST., THE NEXT ANTITRUST AGENDA: THE AMERICAN ANTITRUST INSTITUTE’S TRANSITION REPORT ON COMPETITION POLICY TO THE 44TH PRESIDENT OF THE UNITED STATES 95–137 (2008), available at <http://www.antitrustinstitute.org>.

¹⁷ *Id.* at 95 (citing the packing of meat, the processing of chicken, the harvesting of hardwood timber in the Pacific Northwest, the employment of professional athletes, the provision of health insurance, and the retailing of toys and games, groceries, and books).

¹⁸ *Id.* at 99.

classic monopsony power and its effects, whether beneficial or harmful, are likely to be more widespread.¹⁹

For example, a retailer that controls 20 percent of a national market can make both price and nonprice demands on an individual supplier via a take-it-or-leave-it or all-or-nothing offer that in practice gives the supplier less real choice than a consumer would have if one seller controls 90 percent of the same product market. In some cases, this should be deemed a sufficient degree of dominance to warrant intervention by both the FTC and the European Commission, in the event that the dominance is abused.

There are undoubtedly difficult questions relating to what would constitute an unfair method of competition or an abuse of dominance by a non-monopsonist buyer,²⁰ but if the possibility of anti-competitive effects is realistic and will play an increasingly important role in economic life, as we strongly believe, then both the FTC and European Commission should be trying to provide guidance as to the line between proper and improper exercise of buyer power. If the guidance is joint or at least quite similar, this would be a major contribution to convergence and would help clarify an important area of competition policy that is probably still in its infancy.

Price Discrimination Policy Could Be Developed Under Section 5

It is well-recognized that price discrimination by a company with market power can be anticompetitive under certain circumstances but that it can be pro-competitive under other circumstances.²¹ The Robinson-Patman Act, which is the United States' principal law for dealing with price discrimination, is generally not enforced by the federal government because of its complexity, the nearly open-ended exemption for meeting competition, and its propensity for being used for anticompetitive outcomes. Section 2 of the Sherman Act also can be used against price discrimination in certain circumstances. It is fair to say that price discrimination is a confusing area of law, in which the competitive process can under some circumstances be harmed and businesses can find it difficult to ascertain whether their price (and sometimes non-price) policies expose them to liability.

But Section 5 could be utilized, again in consultation with the Europeans, to develop a series of parallel guiding statements as to what practices will be deemed by the FTC and the European Commission to constitute unfair methods of competition. We believe that a market power screen is necessary in this regard, but that price discrimination can, under identifiable circumstances, be used anticompetitively by a firm with less market power than a monopolist.²²

¹⁹ *Id.* at 104.

²⁰ *See generally id.* at 103–30.

²¹ *See id.* at 130–35.

²² *Id.* at 133 (“All that would be required [under an AAI proposal for reforming the Robinson-Patman Act] is proof that competition was sufficiently imperfect that a seller had the incentive and the ability to undertake significant, persistent, unjustified favoritism.”). In Europe, Article 82(2)(c) offers parallel protection to the R-P Act, prohibiting dominant firms from “applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.” ELHAUGE & GERADIN, *supra* note 2, at 399. Article 82(2)(a) also prohibits a dominant firm from “directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions.” *Id.* at 400. We are not endorsing, however, an interpretation of Section 5 that would prohibit exploitation of legitimate market power through excessive pricing.

Developing Structure for RPM Rule of Reason Cases Could Be an Example of Bridging the Gap Between Section 5 and Europe's Article 81

Thus far we have focused on the relationship between Section 5 and Article 82. Here we focus on the example of resale price maintenance (RPM) as an example of bridging the gap between Section 5 and Article 81.

The Supreme Court in *Leegin*²³ called on the legal system to develop a methodology for dealing with resale price maintenance under a rule of reason regime. One potential approach already exists in the form of the European Commission block exemption regulation applicable to vertical restraints, and the guidelines associated with it.²⁴ According to the EC's guidelines, there is a rebuttable presumption that an agreement which contains RPM is anticompetitive and will not have positive effects or that, where efficiencies are likely to result, these will not be passed on to consumers and/or that RPM is not indispensable for creating these efficiencies. But it is always possible for the firm in question to come forward with substantiated claims that the RPM will bring about efficiencies. When this occurs, the European Commission then is forced to show the likely or actual negative effects. If the efficiencies outweigh the negative effects and the other conditions such as the indispensability test are also fulfilled, the agreement is not prohibited.

The European Commission will be re-evaluating its Vertical Restraints policies in 2010, and the work on this has already begun. The EC case law and practice toward RPM is apparently more flexible than the United States per se approach that was overturned. It is also more forthright and explicit, in that it contains no *Colgate* doctrine to confuse and perhaps obliterate any RPM prohibition. I believe that the FTC could apply its jurisdiction under Section 5 and work in conjunction with the European Commission to agree on a rebuttable presumption and burden-shifting approach very similar to, if not identical with, the current EC guidelines to arrive at a structured rule of reason approach which meets the Supreme Court requirements.

With respect to the RPM question and the price discrimination question addressed in the previous section of this article, I am making the recommendation that the Federal Trade Commission use its tools for providing prospective guidance to bring greater clarity and predictability, with or without EC coordination. Taking the long range picture into account, I think it would be worth the additional effort to try to produce compatible if not fully harmonious guidance. ●

²³ *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007).

²⁴ See generally Luc Peepkorn, *Resale Price Maintenance and Its Alleged Efficiencies*, 4 EUR. COMPETITION J. 201 (June 2008) (going into more detail both on European policy and on the potential applicability in the US). The AAI's position on RPM, calling for the FTC to develop a structured rule of reason approach, is set out in AMERICAN ANTITRUST INSTITUTE, *supra* note 16, at 88–92.