Paper Trail: Working Papers and Recent Scholarship

Editor's Note: *In this edition, we look at a very recent paper by Herbert Hovenkamp that analyzes the differences between the U.S. and EC standards governing dominant firm conduct. Send your comments and suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.*

—William H. Page and John R. Woodbury

Recent Papers

Herbert Hovenkamp, The Legal Periphery of Dominant Firm Conduct (U. Iowa Legal Studies Research Paper No. 07-21, Sept. 1, 2007), http://ssrn.com/abstract=1014426

In this paper, Herbert Hovenkamp explores two areas of potential liability for single-firm exclusionary conduct—attempts to monopolize and "leverage" of monopoly power from one market to another. He characterizes these grounds of liability as "peripheral" to the core focus of the law on dominant firms' actions that maintain existing monopoly power within a single market. Because these areas pose more than the usual number of textual and theoretical challenges for plaintiffs, however, they provide a useful basis on which to compare and contrast the approaches of European and American law to single-firm conduct.

Hovenkamp begins by observing, as the Supreme Court did in *Copperweld*,[1] that single-firm conduct is generally less suspicious than concerted conduct. One "needs a great deal of theory and analysis to identify the circumstances under which [unilateral] practices are anticompetitive, with the knowledge that they very likely are anticompetitive in only a small proportion of cases." (p.2) Of that small proportion, most cases will involve dominant firm conduct that harms rivals in the same market in which the firm has monopoly power. Only a fraction of anticompetitive cases will involve "peripheral" grounds, either an attempt to monopolize a market in which the defendant does not yet have monopoly power or an effort to leverage existing monopoly power into an adjacent competitive market. Yet these latter grounds for liability, Hovenkamp notes, are of growing importance as firms expand into multiple markets in the global economy.

Attempts. Hovenkamp points out that Section 2 of the Sherman Act specifically prohibits both monopolization and attempts to monopolize while Article 82 of the EC Treaty condemns only abuse of a dominant position, without separately proscribing attempted abuse. Hovenkamp traces the American attempt offense to Section 2's origins as a criminal statute. He also suggests that U.S. law proscribes attempts because of its preference for preserving competitive market structures rather than regulating noncompetitive ones. Punishing attempts to monopolize may prevent the creation of a dominant position that would require more supervision. European law, by contrast, may be more content to regulate dominant positions when they emerge. EC law, for example, regulates excessive pricing, while U.S. law recognizes that a firm has a right to charge what the traffic will bear.

[1] Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 767–69 (1984).

That said, however, Hovenkamp concludes that, in practice, the attempt offense does not significantly distinguish U.S. from EC law. At one time, some lower federal courts had endorsed the Ninth Circuit's holding in *Lessig*[2] that a plaintiff could establish an illegal attempt by showing that the defendant had a specific intent to monopolize, even if the plaintiff failed to show that the defendant had an objective probability of achieving a monopoly. In *Spectrum Sports*,[3] however, the Supreme Court made clear that the attempt offense requires the plaintiff to prove that the defendant's actions have a dangerous probability of success. In practice, this element requires proof that the defendant has a market share within striking distance of monopoly. Hovenkamp argues, however, that this requirement is not that far from EC law, which treats market shares of 40 percent or even lower as "dominant." Under EC law, a firm with a 50 percent share could face liability for abuse, even if its conduct only *maintained* that share; under U.S. law, in contrast, a 50 percent firm would be liable for attempt to monopolize only if its conduct threatened substantially to *increase* its share. Both systems, however, recognize that lower market shares make some conduct, like predatory pricing, less likely to be successful.

Leveraging. Hovenkamp then turns to the issue of "leveraging" monopoly power in one market in order to gain an advantage in another market. He first notes that the language of Article 82 seems more naturally to encompass such an offense. Section 2 prohibits only some form of "monopolization," a word that does not easily cover acts that merely confer a competitive advantage. Moreover, recent Supreme Court decisions, such as *Spectrum Sports* and *Trinko*,[4] have confirmed that, to establish a leveraging claim, a plaintiff must prove a dangerous probability of monopolizing the second market. Article 82, on the other hand, proscribes "abuse" of dominance, a word that could plausibly encompass many actions far short of monopolization, including leveraging. Hovenkamp illustrates this distinction with a hypothetical based on the EC and U.S. *Microsoft* cases:

> Suppose that at one point in history there was a highly competitive market for computer solitaire games, which people could purchase and install on their computers. Now Microsoft, with a near monopoly in its Windows operating system, incorporates a pretty good solitaire game into the program and includes it in the price. So now everyone who purchases a copy of Windows, whether standalone or as part of a computer system, obtains a copy of MS solitaire. If solitaire games were perfectly fungible Microsoft would wipe out the independent market for solitaire games. However, there is in fact considerable product differentiation among solitaire games. As a result, Microsoft's bundling cuts the volume of solitaire games sold by perhaps 40% or even more, but firms do keep on selling them. (p.14)

Hovenkamp suggests that, "if Microsoft accomplished this bundling by means of a contract it would very likely be actionable tying under U.S. law" (*id.*) as an illegal tying arrangement under Section 1 of the Sherman Act but "if Microsoft accomplishes its solitaire bundling simply by including that game's code within the code for the Windows operating system, then U.S. law treats the conduct as unilateral" (pp. 14–15) and the plaintiff would have to prove monopoly maintenance in the operating system market or a dangerous probability of monopolization of the game market. Hovenkamp suggests that EC law would requiring a "lesser showing" of an effect on the solitaire market to establish that the technological bundle violated Article 82. This difference, he reasons, "explains the differing approaches in the U.S. and EU actions against Microsoft." (p.15) The EC

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[2] Lessig v. Tidewater Oil Co., 327 F.2d 459 (9th Cir. 1964).

[3] Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 459–60 (1993).

[4] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 415 n.4 (2004).

focused on effects of Microsoft's bundling on the media player market, while the U.S. case focused on effects in the operating system market, particularly its role in preventing the browser from evolving into a rival platform.[5]

Hovenkamp goes on to suggest that U.S. antitrust law has been "overly aggressive" (p.17) in condemning leverage in the context of tying but incongruously less so in cases that cannot easily be characterized as ties. He also notes, however, that "antitrust policy in the United States over the last three decades has been heavily influenced by the Chicago School critique of the 'classical' leverage theory." (p.18) The classical theory was that a firm could earn two monopoly profits by tying the sale of a monopolized good to the sale of a complementary good that is sold in a competitive market. Chicago analysts showed, however, that, where the goods are used in fixed proportions, the monopolist could fully exploit its monopoly without the tie. It *could* monopolize the tied product market, but it had no real incentive to do so. This result makes leveraging claims less plausible.

Hovenkamp correctly notes, however, that later theories have shown that the Chicago critique was overstated, and that, in narrowly defined circumstances, a monopolist could use tying for various monopolistic ends. Hovenkamp again cites *Microsoft*, whose

> bundling of Internet Explorer with Windows was manifestly not a mechanism by which Microsoft hoped to earn two monopoly profits, one on Windows and one on Internet Explorer. Rather, it was a way of ensuring that the platform market would not become competitive as technology permitted an evolution toward web-based rather than workstation-based programs and multi-platform communications capabilities that threatened to make Windows won among many platforms. (p.19)[6]

Hovenkamp concludes that, while there are some linguistic differences between the U.S. and EC standards governing dominant firm conduct, those differences are less important in practice than they might appear. We may have occasion to revisit this conclusion in the wake of the decision of the European Court of First Instance in the European *Microsoft* case. ●

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[5] Hovenkamp's discussion of this hypothetical is somewhat confusing. The government in the U.S. case alleged that Microsoft's bundling of the browser with Windows constituted both monopolization of the operating system market in violation of Section 2 and tying in violation of Section 1. Judge Jackson held the tie illegal under the per se rule, but the D.C. Circuit reversed on this issue, holding that, at least in a case involving integration of platform software, a rule of reason analysis was more appropriate. United States v. Microsoft Corp., 253 F.3d 34, 84–95 (D.C. Cir. 2001). (As a Catch-22, the court of appeals required the government on remand of the Section 1 claim to prove an anticompetitive effect in the browser market but forbade the government from proving that a browser market exists. *Id.* at 95. The government, not surprisingly, dropped the tying claim after remand.) But the court of appeals did *not* hold that Section 1 was inapplicable simply because the tie was accomplished by technological bundling. After all, even technological tying involves a contract. Thus, in Hovenkamp's hypothetical, the solitaire bundling would certainly constitute a tie of separate products under Section 1. Whether it would fall under the per se rule is less clear, but if it were analyzed under the rule of reason, the issue of legality should not (in principle) differ materially from an analysis under Section 2.

[6] This is an accurate statement of the U.S. government's theory of liability in *Microsoft*, and it won the day. Nevertheless, it is not clear that the theory of liability is supported by a plausible economic theory. The best theory proposed to support the government's case is presented in Dennis W. Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 RAND. J. ECON. 194 (2002). John Lopatka and I suggest that the theory's conditions are not satisfied by the findings in the government case. *See* WILLIAM H. PAGE & JOHN LOPATKA, THE *MICROSOFT* CASE: ANTITRUST, HIGH TECHNOLOGY, AND CONSUMER WELFARE 156–62 (2007).