

**Federal Trade Commission/Department of Justice
Hearings on Single-Firm Conduct
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**The Economics of Monopolization
A Simple (as possible) Antitrust Analysis**

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Much Recent Action in the Courts

- ❖ Boundary with law or regulation

- Trinko (Supreme Court)
- Xerox (Federal Circuit)

- ❖ Pricing

- Spirit (6th Circuit)
- AA (District Court)

- ❖ Bundling & c.

- LePage's (3rd Circuit)
- Microsoft (DC Circuit)
- Dentsply (3rd Circuit)

All working on the standards for monopolization / exclusion under § 2

A Rule of Reason Enquiry

- ❖ Structure is economic
- ❖ Economics enters at two key junctures
 - Market power (should be competitive effects!)
 - Causation from alleged anticompetitive acts to changes in market power
- ❖ Much can be gained by thinking carefully about the competitive effects and causation arguments first

Consistent with judicial analysis in bundling cases

Difficult!

- ❖ Most exclusionary conduct would be an ordinary and competitive business practice in some or even most industries.
- ❖ Legal Perspective
 - § 2 leads to an unstructured rule of reason analysis
- ❖ Economic Perspective
 - Monopolization leads to a highly structured competitive effects analysis

Dentsply:

Economic Analysis of Monopoly Maintenance

- ❖ There *is* a monopoly in prefab artificial teeth.
-

- ❖ There *could be* competition in the market from a number of far smaller and lower priced competitors.
-

- ❖ But exclusive contracts with dealers block smaller competitors from offering consumers effective tooth choice.

... Horizontal competitive effects

- ❖ The impact of Dentsply's contracts is to reduce competition in the market for prefab artificial teeth.

...Vertical restraints logic

- ❖ Dentsply's contracts are with third parties, the dealers. Their economic effect is to prevent valuable distribution contracts between the third parties and Dentsply's competitors.
 - vs. Efficient Vertical Contracts

Theory of (Anti)Competitive Effects

More Market Power for Defendant(s)



Exclusionary Act

Less Market Power for Defendant(s)

Dentsply Theory – Much for Plaintiff to Show

- ❖ There *is* a monopoly in prefabricated artificial teeth.

More Market Power for Defendant(s)



Less Market Power for Defendant(s)

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- ❖ There *could be* competition in the market from a number of far smaller and lower priced competitors.

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Exclusionary Act

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Much for Plaintiff to Show Market Power (Competitive Effects) & Causation

- ❖ There *is* market power, but there *could be* competition...
 - Usual investigation of market power (analysis of substitution to competitors, entry barriers) ..
 - ... rendered more difficult for plaintiff by the requirement to show that a more competitive regime could arise.
 - The most direct route for plaintiff: show that entry barriers arise from challenged acts
- ❖ Bulk up this enquiry of causation
 - Why do third parties go along with anticompetitive contracts?
 - Why is use of third parties an effective barrier?

Much for Plaintiff to Show

Test vs. Efficiency Theories

- ❖ (v.1) Would the anticompetitive acts be profitable for defendant and make business sense *without* diminishing competition?
 - aka the “sacrifice” test.
 - Does the act involve a departure from ordinary business (competitive) behavior that is costly to the firm?
 - Will the firm recoup that cost only through monopoly power?

- ❖ (v.2) (Called for by every monopolization defendant in living memory.) Calculate how well off is society (or are consumers) with and without the conduct.
 - My theoretical colleagues’ “assume you have a can opener”

x v. Microsoft 3.1
US v. Microsoft (Browser Case)

Microsoft Monopoly Maintenance Example

❖ There *is* a Windows monopoly.

More Market Power for Defendant(s)



Less Market Power for Defendant(s)

❖ There *could be* dynamic competition for the operating system market *if* Internet entrepreneurs built standards in new markets.

More Market Power for Defendant(s)



Exclusionary Act

Less Market Power for Defendant(s)

❖ But contracts with distributors and with other complementors kept the Internet entrepreneurs from getting a market test.

More Market Power for Defendant(s)



Exclusionary Act

Less Market Power for Defendant(s)

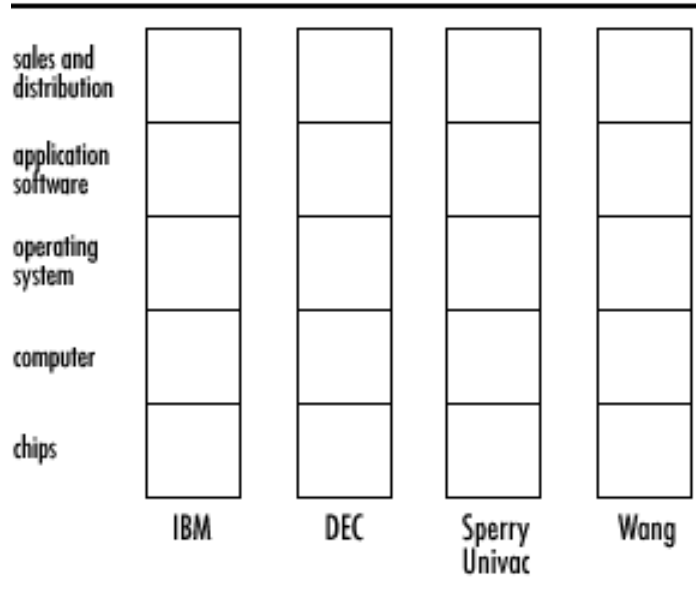
Economics of the PC Industry Very Relevant

- ❖ Internet Entrepreneurs were not horizontal competitors for Windows.
 - Browser from Netscape, Java from Sun not operating systems
 - Industry experience is that vertical disintegration leads to competition for the market
 - Microsoft Internal documents foreground this (rare) feature of this industry

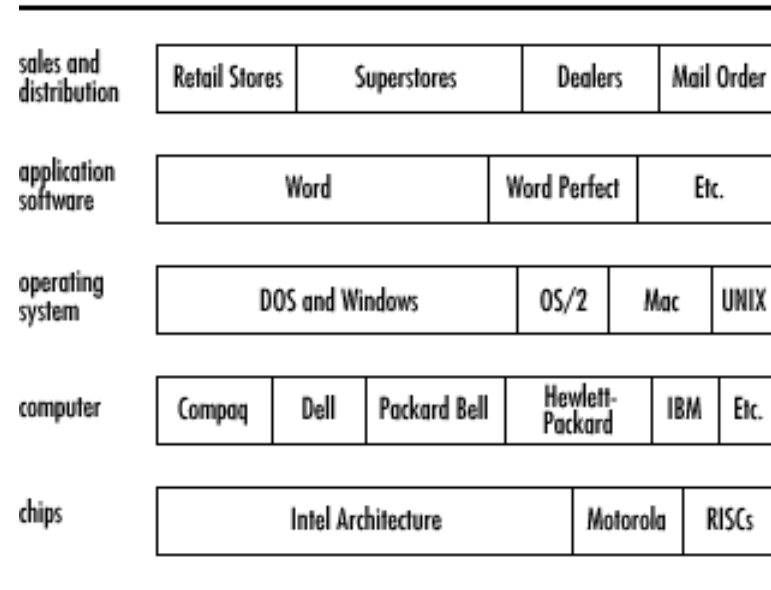
PC Industry View of Vertical Disintegration

Andrew S. Grove

The Old Vertical Computer Industry —
Circa 1980



The New Horizontal Computer Industry —
Circa 1995
(not to scale)

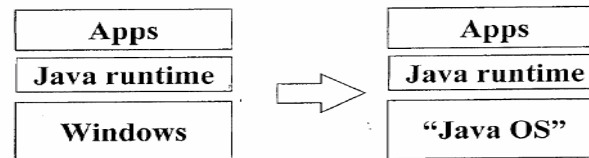


More competitive,

More innovative

Two (of many) Internal Discussions

❖ Paul Maritz:



❖ Bill Gates

A new competitor "born" on the Internet is Netscape. Their browser is dominant, with 70% usage share, allowing them to determine which network extensions will catch on. They are pursuing a multi-platform strategy where they move the key API into the client to commoditize the underlying operating system. They have attracted a number of public network operators to use their platform to offer information and directory services. We have to match and beat their offerings including working with MCI, newspapers, and other who are considering their products.

One scary possibility being discussed by Internet fans is whether they should get together and create something far less expensive than a PC which is powerful enough for Web browsing. This new platform would optimize for the datatypes on the Web. Gordon Bell and others approached Intel on this and decided Intel didn't care about a low cost device so they started suggesting that General Magic or another operating system with a non-Intel chip is the best solution.

Antitrust in Network Industries ... is ordinary antitrust

Government's theory of the case: competition for the market against Windows.

Competition in the market is rare in industries like this.

... the rest of *Microsoft* is much like *Dentsply*

- ❖ Anticompetitive contracts were with third parties, such as sellers of computers and providers of online access.
 - Prevent widespread distribution of browser, java

- ❖ Plaintiff needed to show lack of distribution was causal and Defendant could show (as in *Dentsply*) that it was not

Microsoft's Trial Defenses

- We have no market power
 - Competition or the imminent threat of competition from everything (down to the electric toaster) against Windows
- Our reaction to the browser wasn't strategic
 - No competitive threat from the Internet entrepreneurs, the CEO "had no idea what Netscape was doing at that time."

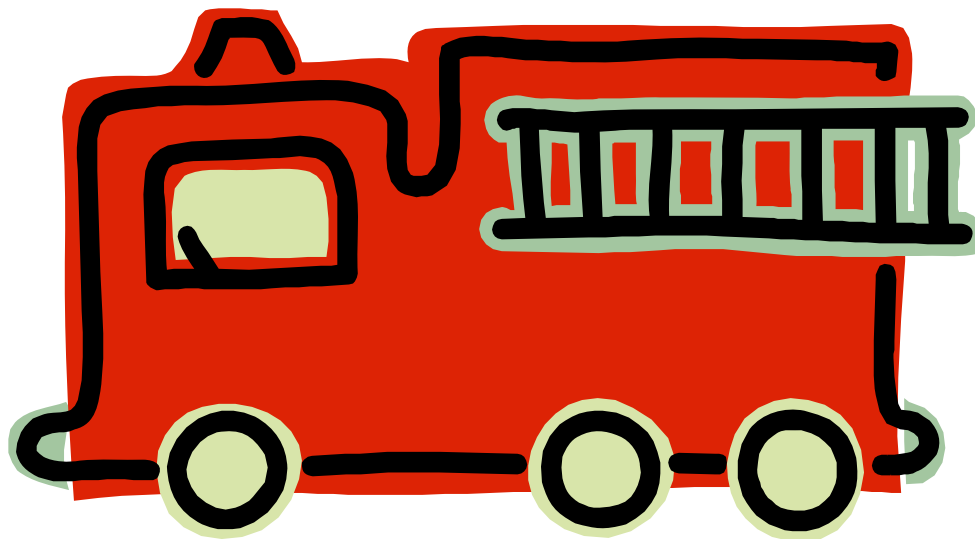


Microsoft Remedy Fizzle

Government Settles

States Go On

Class Action Attorneys Emerge



Defense Options

Argue that vertical restraints can't ever be anticompetitive.

Argue that vertically restricting the existing distribution system isn't anticompetitive because (either)

Entry barriers in distribution are low.

Distributors could refuse exclusive contracts if they were anticompetitive.

Present affirmative efficiencies story of exclusivity (free riding?)

Argue that there is never monopoly power.

Argue that there is no monopoly power (no entry barriers and no efficient entrants)

Argue that competition would not change absent exclusive contracts (causation)

Common Elements in *Dentsply* and *Microsoft*

Potential of Existing Monopoly to Change

Dentsply, Competition in the market for teeth

Microsoft, Competition for the operating system market

Causal Link Between Alleged Acts and Monopoly Maintenance

Dentsply, Exclusive contracts nakedly excluded competitor

Microsoft, Exclusive (de facto) contracts excluded browser & java; entry barriers in operating system market would have fallen otherwise

Both changes in market power and causal links are amenable to economic analysis

Easy Errors to Make (Ignoring Economics)

- ❖ Proper Assessment of Competitive Effects requires proof of harm to competition, not just to competitors
- ❖ Plaintiff error: we were harmed,
...so competition must have been harmed.
- ❖ Defendant error: they were harmed,
...so this is case about harm to competitors, not harm to competition.
- ❖ Plaintiff: Prove market power but not that it could go away
- ❖ Defendant: Attempt, implausibly, to disprove market power pre-trial
 - Leaves economist expert incredible

Lessons from Dentsply and Microsoft

Monopolization is dependent on highly industry specific conditions.

- ❖ Market must be capable of having two competitive regimes.
 - Economic Analysis relevant
- ❖ Exclusionary practices must have enough causal heft to move market to less competitive regime.
 - Economic Analysis relevant
- ❖ ...monopolization cases will be rare (\neq nonexistent).
- ❖ ...enquiry will be highly specific to industry and will turn on economic analysis of changes in competition and of causal impact of alleged exclusionary practices