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The Price is Right (or Wrong)?

An Antitrust Update on the Treatment of Pricing Practices Under Sherman Act Section 2

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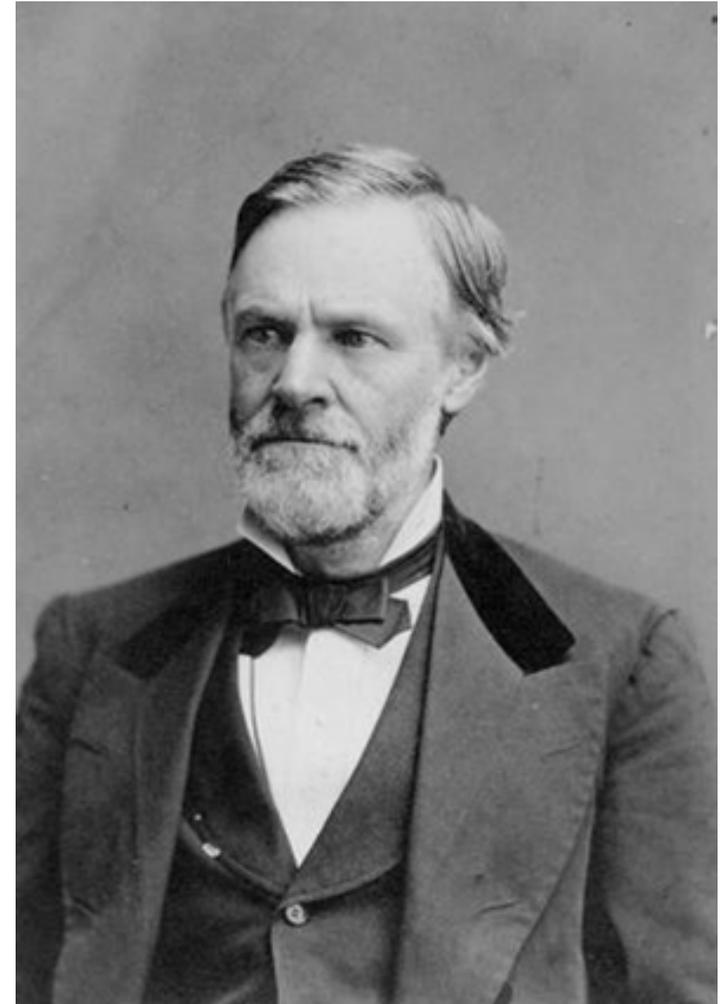
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Background: Section 2 of the Sherman Act

Sherman Act Section 2

“Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony.”

15 U.S.C. § 2.



“M’ for Monopolist is today’s scarlet letter”



Break up big tech's 'monopoly', smaller rivals tell Congress hearing

Justice Department Opens Antitrust Review of Big Tech Companies

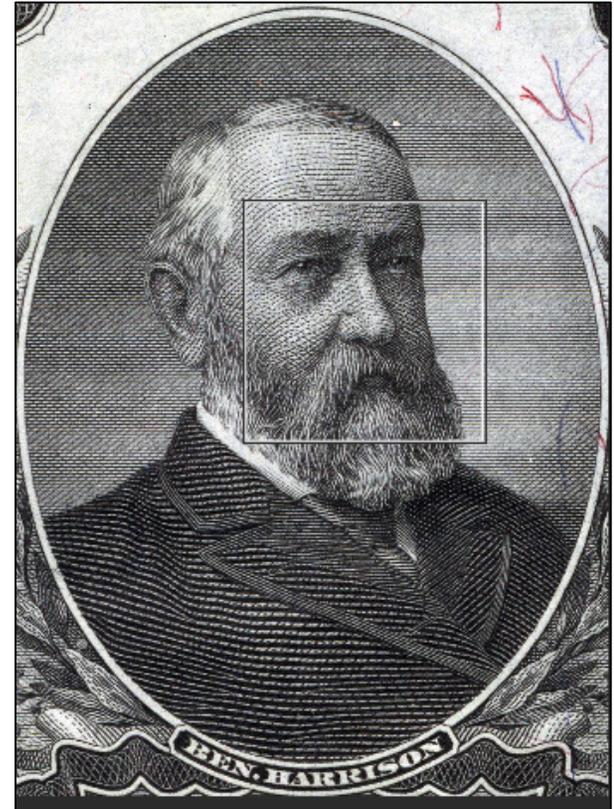
2019 in Review: Barrage of Big Tech Probes Is Unprecedented, Experts Say

Qualcomm's 'No License, No Chips' Model Illegal, Judge Rules

Purpose of Section 2

“Ever since Congress overwhelmingly passed and President Benjamin Harrison signed the Sherman Act in 1890, **‘protecting consumers from monopoly prices’** has been ‘the central concern of antitrust.’”

Apple Inc. v. Pepper, 139 S. Ct. 1514 (2019)



Elements of a Section 2 Violation

Monopolization

- ✓ Monopoly power in relevant market
- ✓ Anticompetitive conduct

Attempted Monopolization

- ✓ Dangerous probability of achieving monopoly power in relevant market
- ✓ Anticompetitive conduct
- ✓ Specific intent to monopolize

Monopoly Power

A firm can exert monopoly power when, “by restricting its own output, it can restrict marketwide output and, hence, increase marketwide prices.” *Rebel Oil Co. v. Atl. Richfield Co.*, 51 F.3d 1421 (9th Cir. 1995)

- In rare instances, monopoly power is established with direct evidence.
- Market share is used as an indicator in other cases: ninety percent “is enough to constitute a monopoly; it is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three percent is not.”

United States v. Aluminum Co. of America, 148 F.2d 416, 424 (2d Cir. 1945)



Monopoly Prices v. Monopolization

Obtaining or maintaining a monopoly **is not** by itself unlawful:

- “The Sherman Act does not attack every monopoly.” *Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536 (9th Cir. 1991)
- “The successful competitor, having been urged to compete, must not be turned upon when he wins.” *United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945)
- “[T]he lawful monopolist should be free to compete like everyone else; otherwise the antitrust laws would be holding an umbrella over inefficient competitors.” *Olympia Equip. Leasing v. Western Union Tel. Co.*, 797 F.2d 370 (7th Cir. 1986)

Monopoly Prices v. Monopolization

- Charging monopoly prices **is not** by itself unlawful

“The mere ... charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. [It] is what attracts ‘business acumen’ in the first place; it induces risk taking that produces innovation and economic growth.” *Verizon Communs. v. Trinko*, 540 U.S. 398 (2004)

“Setting a high price may be a use of monopoly power, but it is not in itself anticompetitive.” *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979)

- Monopolization (or attempted monopolization) through anticompetitive conduct **is** unlawful

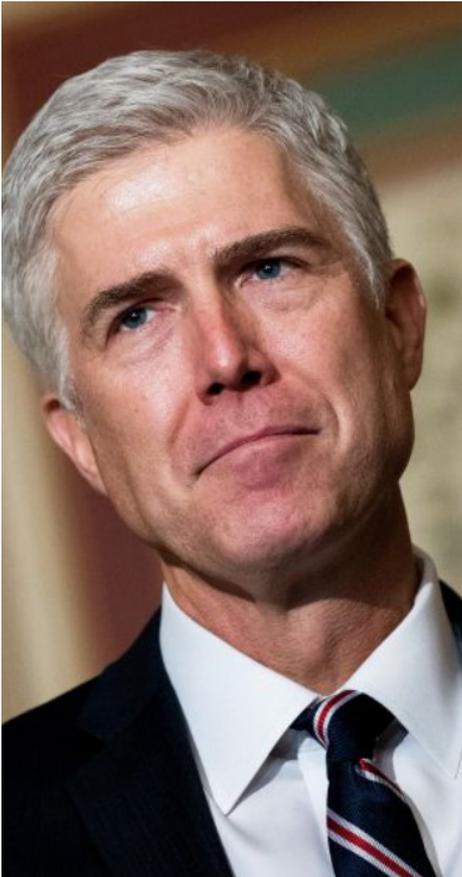
“The Supreme Court has consistently held that there must be ‘predatory’ conduct to attain or perpetuate a monopoly for a monopolist to be liable under Section 2.” *Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536 (9th Cir. 1991)

Price Squeeze: *Pac. Bell Tel. Co. v. Linkline*, 555 U.S. 438 (2009)

- Customer-competitor alleged “price squeeze”—where the wholesale price is high and retail is price low.
- The plaintiff claimed “that the defendants (upstream monopolists) abused their power in the wholesale market to prevent rival firms from competing effectively in the retail market.”
- The Supreme Court stated that “*Trinko* holds that such claims are not cognizable...in the absence of an antitrust duty to deal.”
- “[A] defendant with no antitrust duty to deal with its rivals has no duty to deal under the terms and conditions preferred by those rivals.” If the defendant “had simply stopped providing...service to the plaintiffs, it would not have run afoul of the Sherman Act.”



What Qualifies As Anticompetitive Conduct Under §2?



“[T]he question we often find ourselves asking is whether... **the conduct at issue before us has little or no value beyond the capacity to protect the monopolist’s market power**—bearing in mind the risk of false positives (and negatives) ..., and the limits on the administrative capacities of courts to police market terms and transactions.”

Novell v. Microsoft, 731 F.3d 1064 (10th Cir. 2013)

Pricing Practices as Anticompetitive Conduct

“If a firm has been ‘attempting to exclude rivals **on some basis other than efficiency,**’ it is fair to characterize its behavior as predatory.”

Aspen Skiing v. Aspen Highlands Skiing, 472 U.S. 585 (1985)

Pricing practices that have been deemed anticompetitive:

- Below-cost (predatory) pricing
- Bundling
- High-volume/loyalty discounts and other “coercive” prices

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Predatory Pricing

Predatory Pricing

Pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run

“[P]redatory pricing schemes are rarely tried, and even more rarely successful.”

Matsushita Electric Industrial Co. v. Zenith Radio, 475 U.S. 574 (1986)

Can Prices Be Too Low?

- “[C]utting prices in order to increase business often is the very essence of competition.” *Matsushita Electric v. Zenith Radio*, 475 U.S. 574 (1986)
- “Low prices benefit consumers regardless of how those prices are set.” *ARCO v. USA Petroleum Co.*, 495 U.S. 328 (1990)
- “[T]he mechanism by which a firm engages in predatory pricing—lowering prices—is the same mechanism by which a firm stimulates competition ... [M]istaken inferences ... are especially costly, because they chill the very conduct the antitrust laws are designed to protect.” *Cargill v. Monfort of Colorado*, 479 U.S. 104 (1986)

Predatory Pricing: *Brooke Group v. Brown & Williamson*, 509 U.S. 209 (1993)

- Must prove that **prices are below an appropriate measure of the alleged predator's costs**
- “[B]elow-cost pricing must be capable, as a threshold matter, of producing the intended effects on the firm’s rivals [by] **driving them from the market.**”
- Must prove that defendant had a **dangerous probability of recouping** losses from below-cost prices “[t]hat below-cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured....”



Recoupment

- The Supreme Court has underscored “the centrality of recoupment to a predatory-pricing scheme.” *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 549 U.S. 312 (2007)
- For a predatory pricing scheme to succeed, “it is not enough simply to achieve monopoly power.” Recoupment “depends on maintaining monopoly power for long enough both to recoup the predator’s losses and to harvest some additional gain.” *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986)
- Determining whether recoupment is likely “requires an estimate of the cost of the alleged predation and a close analysis of both the scheme alleged by the plaintiff and the structure and conditions of the relevant market.” “In certain situations—for example, where the market is highly diffuse and competitive, or where new entry is easy . . . summary disposition of the case is appropriate.” *Brooke Group v. Brown & Williamson*, 509 U.S. 209 (1993)

The Price-Cost Test

The Areeda-Turner Price-Cost Test

- Reasonably anticipated marginal cost
- Average variable cost a proxy for MC
- $\text{Prices} > \text{MC} = \text{lawful}$
- $\text{Prices} < \text{MC} = \text{presumed predatory}$

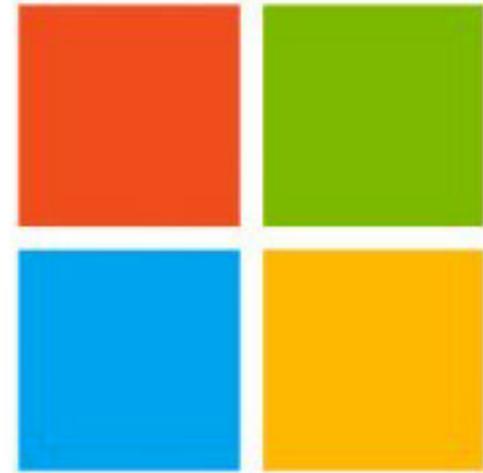
“Whatever the proxy used to measure marginal cost, it must be accurate and reliable in the specific circumstances of the case.”

U.S. v. American Airlines, 335 F.3d 1109 (10th Cir. 2003)



Predatory Pricing: *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001)

- The plaintiffs argued “that by pricing below cost on IE (indeed, even paying people to take it), Microsoft was able simultaneously to preserve its stream of monopoly profits on Windows, thereby more than recouping its investment in below-cost pricing on IE.”
- The DOJ abandoned this theory on appeal, and the Court held that “[t]he rare case of price predation aside, **the antitrust laws do not condemn even a monopolist for offering its product at an attractive price**, and we therefore have no warrant to condemn Microsoft for offering either [Internet Explorer] or the [Internet Explore Administration Kit] free of charge or even at a negative price.”



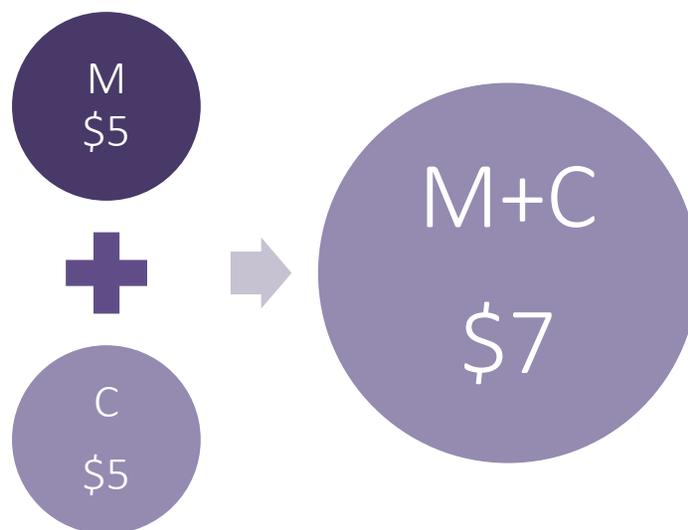
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Bundling

Multi-Product Discounts/“Bundling”

When a firm sells a bundle of goods or services for a lower price than the seller charges for the goods or services purchased individually

Issue: Can multi-product or “bundled” discounts by a monopolist violate the antitrust laws if they are alleged to exclude a producer of *only a single product* in the bundle, who may not be able to match price created by the multi-product bundled discount?



Multi-Product Discounts/“Bundling”

LePage’s v. 3M, 324 F.3d 121 (3d. Cir. 2003)

- Even though price > cost, held to violate §2 given plaintiff’s single product business could not profitably absorb the costs of the defendant’s multi-product rebates



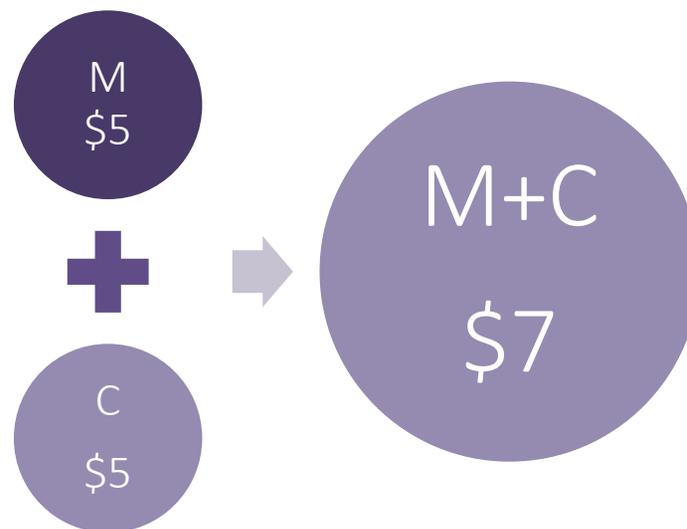
Cascade Health Solutions v. PeaceHealth, 515 F.3d 973 (9th Cir. 2008)

- Rejects *LePage’s* by holding “bundled discounts” are not exclusionary unless price is less than the appropriate measure of defendant’s costs under “discount attribution” standard:

$$\text{Price}_{\text{Competitive}} - \text{Package Discount} > \text{Relevant Cost}_{\text{Competitive}}$$

- But no recoupment requirement

Multi-Product Discounts/“Bundling”



Package discount = $\$5 + \$5 - \$7 = \3

Is $\$5 - \$3 = \$2 > AVC$ for Product C

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“Coercive” Pricing Practices

Loyalty and Volume Discounts

- Discounts or rebates contingent on purchaser buying all or a specified percentage or volume of its requirements from a given supplier
- Simple volume discounts generally upheld
- “[A] plaintiff seeking to establish competitive injury resulting from a rival’s low prices must prove that the prices complained of are below an appropriate measure of its rival’s costs.” *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993)
- Key question for more complex arrangements is whether they should be evaluated under exclusive dealing or predatory pricing standards?
 - Several circuits have applied the price-cost test to forms of loyalty discounts/exclusive dealing, even where plaintiffs disclaimed “predatory pricing”



Exclusive Dealing

- An agreement that requires a customer or supplier to deal exclusively with a company for a particular good or service
- In evaluating lawfulness, courts look to degree of market foreclosure
 - “[A] monopolist’s use of exclusive contracts ... may give rise to a §2 violation even though the contracts foreclose less than the roughly 40% or 50% share usually required in order to establish a §1 violation.” *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001)
 - Duration of commitment is also significant. *But see United States v. Dentsply Int’l, Inc.*, 399 F.3d 181 (3d Cir. 2005), in which an at-will exclusive distribution deal held illegal
- Other relevant factors: nature of business justifications, market effects

ZF Meritor LLC v. Eaton Corp., 696 F.3d 254 (3d Cir. 2012)

- Defendant in heavy duty truck transmission market had long-term agreements (LTAs) with 4 OEMs
 - 5+ year LTAs with discounts dependent on high penetration targets (70-97% of purchases)
- The Third Circuit considered whether to apply predatory pricing or exclusive dealing framework to review these arrangements



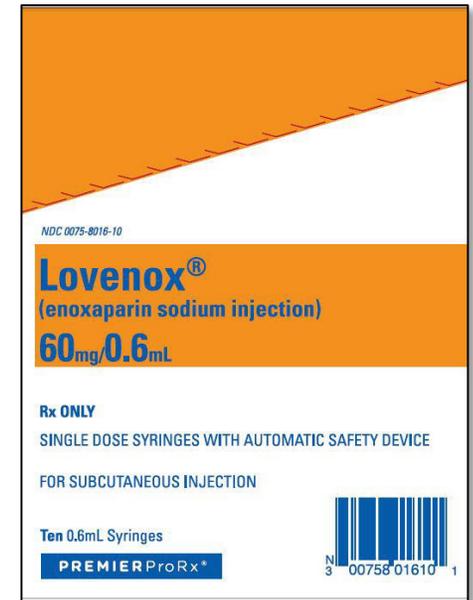
ZF Meritor LLC v. Eaton Corp., 696 F.3d 254 (3d Cir. 2012)

- The Third Circuit recognized the price-cost test for market-share or volume rebates offered by suppliers in a single-product market
- **But** the price-cost test was held “inapposite” if “price itself was not the clearly predominant mechanism of exclusion”
 - Provisions allegedly “block[ed] customer access” to rival products
 - Customer concerns about loss not just of rebates, but of supply
 - Defendant’s status as “supplier of necessary products”



Eisai, Inc. v. Sanofi Aventis U.S. LLC, 821 F.3d 394 (3d Cir. 2016)

- The plaintiff claimed Sanofi’s volume discounts of its anticoagulant drug to U.S. hospitals—which offered variable discounts based on a combination of the volume purchased and the purchaser’s market share—were anticompetitive
- Building off *Eaton*, the Third Circuit suggested, without deciding, that the price-cost test would not apply: “On [Plaintiff’s] telling, the bundling—not the price—served as the primary exclusionary tool”
- By suggesting that bundling of “contestable” and “incontestable” demand is unlike a case in which a firm “uses a single product loyalty discount or rebate,” the court may have signaled that the price-cost test never applies to cases in which a loyalty discount applies to products for which a portion of demand is “incontestable”



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Special Case: Network Industries

Monopolization in Network Industries

- Multi-sided platforms – social media, search engines, online retail sites – are under investigation for monopolization (FTC, DOJ, States)
- Issues in monopolization in markets with multi-sided platforms:
 - Use of price to detect predation or monopoly
 - Allegations in the press appear to extend monopolization into somewhat new territory – the economics of demand attributes and product selection
 - Role of network effects

Using Price to Detect Predation or Monopoly

Are prices too low?

- Traditional tests for price predation do not apply well in multi-sided platforms
- Zero price for one platform component is a common and often efficient strategy – Low price for one product to make money selling another
 - Analogy with two-part pricing/metering/bundling; ambiguous effects
- Not obvious how to detect exclusionary pricing by multisided platforms

Are prices consistent with monopoly?

- Are prices for profit-generating components consistent with monopoly?
- Consumers “pay” for social media and search by agreeing to allow their information to be used in certain ways
 - One could ask, as authorities seems to be doing: Do they “pay” too much?
- Economics is murky whether a monopolist offers more or less of product attributes like privacy and data security than competitive firms

New Territory In Recent Investigations?

- Current investigations are confidential, but press reports indicate allegations like the following:
 - Put consumer data at risk
 - Acted in ways not responsive to consumer demands due to a lack of meaningful competition in the marketplace
 - Reduced consumers' choices
- These allegations take monopolization into somewhat new territory: the economics of demand attributes and product selection
 - Do firms with market power put data at risk more than firms without market power?
 - Do firms with market power respond more or less to consumer demands than firms with less market power?
 - Is reduced consumer choice an appropriate target of monopolization

Implications of Network Effects

- Multi-sided platform markets are often characterized by strong network effects, or demand-side economies of scale
- In markets with economies of scale, we expect a smaller number of competitors “in equilibrium.”
- Thus, high concentration is arguably less likely to indicate monopolization in network industries than it is in industries with lower economies of scale
- Higher concentration can benefit consumers when there are scale economies
- While it is true that exclusionary practices may raise concentration in network industries, antitrust authorities need to recognize that it is natural and potentially efficient for consumers to have “less choice” in a certain sense in industries with strong network effects

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