Designing Antitrust for the Digital Era

Panel 4: Evidence of Exclusion and Damages

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*The views presented do not necessarily represent those of the Federal Trade Commission.

The American System – Burdens of proof for harm

- Sherman Act Section 1 – concerted action by competitors
  - Per se liability
  - Rule of reason liability
- Sherman Act Section 2 – unilateral action by a dominant firm
  - Always rule of reason
- Per se liability: conduct is so inherently anticompetitive no proof of harm is required and no procompetitive effects accepted
- Rule of reason: plaintiff's actual and potential anticompetitive effects weighed against defendant's procompetitive effects

The American System – Unilateral conduct

- Monopolists are allowed to exert market power
  - Raise price/reduce output
  - Refuse to deal with competitors (most of the time!)
  - Reduce innovation
- There is no liability for exploitation or abuse of dominance
- Exclusion of rivals is the main unilateral harm to competition
- Examine whether the exclusive conduct "reasonable appears capable of making a significant contribution to creating or maintaining monopoly power."

United States v. Microsoft: Case Information (Netscape story)

- Platform market
  - Personal computer (PC) operating systems
  - Internet browsers for PC operating systems
- Microsoft Windows ~95% share of PC operating systems
- Internet browsers for PCs
  - Microsoft Internet Explorer (IE)
  - Netscape Navigator
- Microsoft believed Netscape Navigator was a threat to PC operating system monopoly

United States v. Microsoft: Conduct

- Licensing terms with PC manufacturers requiring promotion of IE or blocking of Navigator on computers
- Technical integration of Windows and IE making it more difficult for consumers to use Navigator
- Agreements with internet access providers, software developers, and Apple to only promote or allow internet access through IE

United States v. Microsoft: Evidence of Exclusion

- Microsoft had market power through Windows dominance
- Econometric evidence that consumer usage share of Navigator dramatically reduced
  - PC manufacturers removed Navigator as a preinstalled option
  - Many consumers effectively barred from using Navigator to access internet
- Drop in consumer usage share removed Navigator as nascent threat to Windows dominance

United States v. Microsoft and Digital Markets

- Dynamic markets
  - Court rejected argument that technology markets are too dynamic to use of structural estimates of market powe
  - Even in dynamic markets structurally based market power analysis can predict short-term anticompetitive effects
- Partial exclusion
  - Not necessary that competitor is foreclosed from all means to market
  - Exclusion from most cost-efficient means of distribution sufficient to constitute anticompetitive harm

United States v. Apple: Case Information

- Two markets involved
  - Platform for purchase of digital format books (Amazon & Apple)
  - Books sold in digital format/ebooks (book publishers)
- 2007-2009, Amazon gained significant market power in ebook market through its Kindle platform
- Book publishers resented Amazon
  - Feared Amazon dominance in digital book platform
  - Did not like Amazon's $9.99 price for new and best-selling books
- Apple saw opportunity to enter digital book platform market

United States v. Apple: Conduct

- Apple suggested agency model to publishers:
  - Publishers would directly set the price of ebooks based on price caps negotiated among Apple and the publishers
  - The digital platform takes a percentage of the sale
  - All digital platforms have to transition to agency model
- Five of six major publishers agreed to follow price caps and agency model
- Publishers forced Amazon to accept agency model
- Publishers set prices of ebooks near agreed price caps

United States v. Apple: Evidence of Harm

- Court agreed that agreement was *per se* price fixing
- Evidence (expert analysis of weighted average price) of actual price increases due to agreement
  - New release ebooks prices increased 24.2%
  - Bestseller ebooks prices increased 40.4%
  - Other ebooks prices increased 27.5%
- Evidence of reduction in output due to agreement
  - Expert testimony estimated 14% fewer sales over agreement period
  - Over 77,000 fewer sales in two weeks after agreement

United States v. Apple and Digital Markets

- Because Apple presented evidence that the ebooks market had new and unusual features, court opinion considered procompetitive arguments
- Agreeing to raise prices in order to enable entry (Apple) to challenge dominant firm (Amazon) is not an acceptable efficiency
- Arguments that publisher agreements led to lower ebook prices rejected because no evidence of causation

In re 1-800 Contacts: Case Information

- Two related digital markets
  - Market for the online sale of contact lenses
  - Market for search keywords used in online search advertising
- 1-800 Contacts had most online contact lens sales and was most expensive
- Competitors heavily depended on paid search advertising in response to search engine keywords used by consumers
- 1-800 Contacts noticed that competitors were paying search engines to display their advertisements when consumers searched for 1-800 Contacts

In re 1-800 Contacts: Conduct

- 1-800 Contacts brought trademark lawsuits against 13 major competitors, all of which ended in settlement agreements
- Settlement agreements terms
  - No use of each other's trademarks when bidding for keywords
  - Must use negative keyword to prevent search engine from displaying advertisements in response to trademark keyword
- 1-800 Contacts enforced settlement terms through legal threats

In re 1-800 Contacts : Evidence of Exclusion and Harm

- Because case involved intellectual property rights, Commission applied the Rule of Reason
- Agreements had a tendency to restrict truthful advertising to consumers that they use to make purchasing decisions
- Actual evidence of anticompetitive effects presented
  - Economic expert testimony that prices were higher due to agreements than they would have been
  - Consumers had worse search results and did not benefit from relevant price information: 114 million fewer ads for competitors
  - Search engine auction process less competitive

In re 1-800 Contacts and Digital Markets

- Intellectual property rights do not always foreclose antitrust review and are used by digital market participants to justify exclusion
- Consumers can be harmed through reduction in truthful information in zero price markets—poor choices and higher prices
- As with many digital markets, presence of IP claims in emerging markets requires consideration of procompetitive justifications

Digital markets summary

- Existing theories of harm apply to new markets
- Efficiency justifications are crucial in new markets even if harm to competition is obvious
- Antitrust liability can apply even where there are intellectual property rights
- Harm to competition can be proven in zero price markets