The Federal Trade Commission and the Sherman Act

Herbert J. Hovenkamp
University of Pennsylvania Law School

Follow this and additional works at: https://scholarship.law.upenn.edu/faculty_scholarship

Part of the Administrative Law Commons, Antitrust and Trade Regulation Commons, and the Law and Economics Commons

Repository Citation
https://scholarship.law.upenn.edu/faculty_scholarship/1813

This Article is brought to you for free and open access by Penn Law: Legal Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship at Penn Law by an authorized administrator of Penn Law: Legal Scholarship Repository. For more information, please contact PennlawIR@law.upenn.edu.
THE FEDERAL TRADE COMMISSION AND THE SHERMAN ACT

Herbert Hovenkamp*

I. INTRODUCTION

II. THE ARGUMENTS FOR AND AGAINST EXPANDING THE REACH OF § 5 BEYOND THE SHERMAN ACT
   A. Opposition to Expansion
   B. Supporting Expansion of FTC Authority

III. FILLING THE GAPS: EXTENDING THE FTC’S LONG ARM TO REACH ANTI-COMPETITIVE ACTS
   A. Attacking Monopoly in its Incipiency
   B. Cartel-Like Behavior
   C. Conduct Analogous to Abuse of Dominant Position

IV. INTEL AND THE OUTER BOUNDS OF THE FTC’S LONG ARM
   A. FTC Claims Against Intel
   B. The FTC’s Requested Remedies

V. CONCLUSION

I. INTRODUCTION

The Federal Trade Commission was created in 1914 with the authority to identify and condemn “[u]nfair methods of competition.” The FTC, originally referred to as an “interstate trade commission,” was part of President Woodrow Wilson’s progressive campaign promise against big business, and much of its support came from, frankly, anti-big-business interest groups. Others really believed that comprehensive federal regulation and even a federal incorporation act would have been superior to the state corporate law system that we continue to have, but they settled on the FTC as a compromise. The FTC Act creates a tribunal headed by five

---

* Ben V. & Dorothy Willie Professor of Law, University of Iowa. Thanks to Christina Bohannan for commenting on a draft. This paper was delivered as the first annual Bayard W. Heath Lecture on antitrust, given at the University of Florida Levin College of Law, February 5, 2010.


Commissioners, not more than three of whom may be from the same political party. Significantly, Congress chose initially not to create an elaborate code of competitive business behavior. Rather, it took its cue from the Sherman Act, which prohibited anticompetitive conduct in only the most general terms. Indeed, the term “unfair methods of competition” is even more general than the Sherman Act’s rather vague condemnation of contracts, combinations, and conspiracies in restraint of trade in § 1 or of every person who shall “monopolize” in § 2.

Read with the aid of nearly a century of hindsight, the term “unfair” seems unfortunate, for it suggests that the Commission was concerned more with business torts than with truly anticompetitive practices. Business torts can encompass many kinds of deceptive or unfair conduct, often without regard to anticompetitive consequences. Indeed, many of those historically accused of business torts are not dominant firms bent on monopoly at all, but rather small, undercapitalized or fly-by-night companies that make their living by deceit or by free riding on the investments of other firms.

The FTC also has authority to enforce the Clayton Act, which includes provisions that prohibit anticompetitive tying arrangements and exclusive dealing, price discrimination, and mergers. The FTC does not have explicit statutory authority to enforce the most important antitrust provision, however, which is the Sherman Act. The Conference Report on the FTC Act is not particularly helpful on the definition of the kinds of conduct that the FTC Act reaches:

It is impossible to frame definitions which embrace all unfair practices. There is no limit to human inventiveness in this field. . . . It is also practically impossible to define unfair practices so that the definition will fit business of every sort in

4. Problem, supra note 2, at 210–11.
6. Id. § 2.
9. Id. § 14.
10. Id. § 13.
11. Id. § 18.
every part of this country. Whether competition is unfair or not generally depends upon the surrounding circumstances of the particular case. What is harmful under certain circumstances may be beneficial under different circumstances.12

The FTC is divided into a Bureau of Competition, which is concerned with anticompetitive practices as defined most generally by the antitrust laws, and a Bureau of Consumer Protection, which is concerned mainly with different types of deceptive conduct, much of which is undertaken by firms that have no prospect of attaining a monopoly.13 Our concern here is entirely with the FTC as an antitrust—or at least as a “quasi-antitrust” enforcement agency.

Today, the jurisdiction of the FTC over anticompetitive practices is well established.14 Not only does the Commission have explicit power to enforce the Clayton Act directly, but also the Supreme Court has held that the FTC’s power to condemn “unfair methods of competition” covers everything that the Sherman Act covers and goes even further to reach a “penumbra” of practices that are not covered by the Sherman Act.

The view that the FTC can condemn practices because they are anticompetitive, even though they do not fall within the literal coverage of the Clayton or Sherman Acts, is historically justified.15 Indeed, the mindset of the Congress that passed both the Clayton and FTC Acts in 1914 was that the Supreme Court had been much too restrictive in its interpretation of the Sherman Act16 and that some expansion was in order.

This Article argues that the FTC should expand its authority, within limits, to reach conduct not addressed by the literal language of either the Sherman or Clayton Acts. Nevertheless, the power to condemn undefined practices that have been held not to violate the Sherman Act is hardly uncontroversial.

II. THE ARGUMENTS FOR AND AGAINST EXPANDING THE REACH OF § 5 BEYOND THE SHERMAN ACT

A. Opposition to Expansion

The arguments against an expansive reach can be summarized as

follows. The Sherman Act is extremely open ended in its identification of anticompetitive practices. Section 1 of the Sherman Act reaches “[e]very contract, combination . . . conspiracy” among multiple firms that is in “restraint of trade.”17 These terms can refer to virtually any practice that has the effect of reducing output and raising price—or those activities that are “anticompetitive” under the ordinary definitions of neoclassical economics. Section 1 of the Sherman Act reaches naked cartels of competitors, vertical agreements, joint ventures, and many mergers, provided that the conduct requires the coordinated efforts of two or more independent economic actors. Further, § 2 of the Sherman Act prohibits firms from monopolizing or attempting or conspiring to monopolize.18 This broad prohibition reaches the full range of practices by which firms that are already dominant maintain their monopolistic positions, as well as all practices by which a firm that is not yet a monopolist might realistically seek to become one. It is hard to imagine a practice that is “anticompetitive” in some meaningful sense of that word and yet is not reachable under these provisions. As Judge Posner once observed in a different context, “Our law is not rich in alternative concepts of monopolistic abuse[.]”19 Reaching beyond what the Sherman Act reaches is likely to condemn practices that are not economically harmful and that might even benefit consumers.

Indeed, historical experience provides considerable warrant for that position. When the Supreme Court has permitted the FTC to reach beyond existing antitrust law to condemn practices as anticompetitive, the FTC has ended up condemning practices that were not anticompetitive at all, by any sensible definition. For example, in the Brown Shoe decision, the Supreme Court upheld an FTC order condemning exclusive dealing by a shoe manufacturer where there was no realistic expectation of harm to competition.20 The Supreme Court rejected the lower court’s conclusion that the FTC was required to show competitive harm. Rather, the Commission has power to “arrest trade restraints in their incipiency.”21 Further, the Court observed that this power “is particularly well established with regard to trade practices which conflict with the basic policies of the Sherman and Clayton Acts even though such practices may not actually

18. Id. § 2.
20. FTC v. Brown Shoe Co., Inc., 384 U.S. 316, 322 (1966). The issue was contested in numerous earlier decisions, with several leaning toward an interpretation of the FTC Act that was more or less limited to the coverage of the Sherman Act. See, e.g., FTC v. Raladam Co., 283 U.S. 643, 647–49 (1931); FTC v. Curtis Pub’g Co., 260 U.S. 568, 581-82 (1923); FTC v. Sinclair Refining Co., 261 U.S. 463, 474-75 (1923); FTC v. Gratz, 253 U.S. 421, 428-29 (1920); cf. FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 239–44 (1972) (finding FTC authority was not limited to the spirit and letter of antitrust laws).
violate these laws.”22 As the Supreme Court would observe two decades later, the “standard of ‘unfairness’ under the FTC Act is, by necessity, an elusive one, encompassing not only practices that violate the Sherman Act and the other antitrust laws, but also practices that the Commission determines are against public policy for other reasons.”23

One problem with decisions such as Brown Shoe is that not only was the challenged activity competitively harmless, but it also did not seem to qualify for condemnation under the FTC’s consumer protection theory either. On the latter point, the practice was not deceptive and did not obviously injure consumers in any way. Indeed, the biggest beneficiaries of such decisions were typically rivals who were injured by more efficient distribution practices. So the decision injured rather than benefitted consumers.24

B. Supporting Expansion of FTC Authority

On the other hand, the rationales for expansive coverage are quite persuasive as a whole and may even be overwhelming. Although, not every rationale that has been offered is equally persuasive. The rationales for the expansionist view that § 5 of the FTC Act reaches beyond the Sherman Act are as follows. First, the FTC Act may be a way to import an “incipiency” concern into the Sherman Act that is present in the language of the Clayton Act but not in the Sherman Act itself.

Second, some cartel-like conduct is not reachable under § 1 of the Sherman Act because that provision’s requirement of a “contract, combination, or conspiracy” in restraint of trade cannot be met. That is, the firms may be able to achieve cartel-like results, as in an oligopoly, without actually agreeing among themselves in any way that satisfies the Sherman Act agreement requirement. By contrast, the FTC Act’s prohibition of

“unfair methods of competition” does not contain any explicit agreement requirement. Third, § 1 of the Sherman Act does not contain an “attempt” provision, and the less categorical language of the FTC Act might be used to read an attempt doctrine into the law of concerted action.

Fourth, in § 2 of the Sherman Act, the prohibition of monopolizing conduct is narrower than the prohibitions used in other countries. For example, the Competition Law of the European Union does not speak of conduct that monopolizes a market but rather of “abuse . . . of a dominant position.” The difference can become quite important when conduct is not reasonably calculated to maintain or create a monopoly but rather represents the dominant firm’s attempt to use its power in some complementary or collateral market in which monopoly cannot be proven to result. From time to time, U.S. courts, including the Supreme Court, have tinkered with the idea of a “leverage” theory, or a theory that taking advantage of one’s monopoly position by causing harm in a collateral market should be unlawful. However, the FTC Act’s “unfair methods of competition” seem well suited for such applications, provided that they are limited to situations in which competitive harm is likely.

Because it is a regulatory agency, the FTC has some structural and procedural advantages over a traditional federal court. The most important of these are that 1) the FTC uses experts as magistrates and ultimate decision makers rather than generalist judges; further, its decision-making is largely limited to anticompetitive and unfair trade practices; 2) the FTC operates under the federal Administrative Procedure Act, which permits more flexible rules of procedure and evidence than traditional judicial processes; and 3) in an FTC proceeding, there is no jury. In addition, the Supreme Court’s recent Twombly decision placed heavy


26. See discussion of this leverage theory infra Part III.C.


28. In Official Airline Guides, Inc. v. FTC, 630 F.2d 920 (2d Cir. 1980), the court rejected an FTC claim that a monopoly publisher of airline schedules violated § 5 by refusing to publish the schedules of small commuter airlines, when the publisher did not operate in the airline market and did not have any prospect of gaining power there. Id. at 926–27.


burdens on a plaintiff pleading an antitrust conspiracy and seeking discovery. By contrast, the FTC should be able to proceed with an investigation on a more general, reasonable-belief standard. This can be a particular advantage in conspiracy cases where the evidence has typically been concealed. As Professor William Page has observed, “[T]o the extent that courts do not allow sufficient pre-answer discovery, the FTC might fill the procedural gap in appropriate cases by exercising its administrative powers of investigation.”

In addition, The FTC Act cannot be enforced by private parties. This, it turns out, is a question of some complexity, but it goes far beyond the traditional concerns of res judicata and collateral estoppel. Under existing law, if an antitrust violation is found in a fully adjudicated case brought by the U.S. Justice Department in a federal court, that decision can be given prima facie effect in a subsequent lawsuit filed by private parties; however, this provision does not apply to findings of the FTC. Further, principles of nonmutual “offensive” collateral estoppel generally hold that a defendant gets a single bite at the apple. Therefore, after a defendant’s condemnation in an antitrust proceeding, those issues that were fully litigated and necessary to the outcome are precluded in a later action brought by a private party. The offensive collateral estoppel application of proceedings brought under the FTC Act is mired in some ambiguity. However, one thing is clear: when the FTC is not proceeding under the antitrust laws at all, but rather is taking advantage of the FTC Act’s reach to conduct that is not even covered by the antitrust laws, then there is no preclusive effect whatsoever.

Indeed, when the FTC brings an action not covered explicitly by antitrust laws, the result could go the other way. For example, an FTC finding that particular conduct violates the FTC Act but not the antitrust laws could be given some weight—although not preclusive effect—in a subsequent private action brought under the antitrust laws. As FTC Commissioners Jon Leibowitz and J. Thomas Rosch recently observed in a statement accompanying the announcement of the FTC’s complaint against Intel, the action was brought under “the stand-alone [§] 5 [of the FTC Act] unfair method of competition claim because liability under that standard has the potential to protect consumers while at the same time limiting Intel’s susceptibility to private treble damages cases.”

Another contrast is in available remedies. Remedies for violations of the FTC Act are typically limited to injunctions (cease and desist orders) that

31. See Page, supra note 29 at 5.
34. On these various possibilities, see 2 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 319a (3d ed. 2006).
36. This is not invariably the case. The FTC has sometimes obtained remedies akin to fines or
prohibit the repetition of certain types of conduct; as a result, they do not encounter the problems of overreaching that are inherent in the antitrust treble damage system.\textsuperscript{37} A great deal of unwarranted expansion in antitrust during the middle part of the 20th Century occurred as a result of private-plaintiff actions.\textsuperscript{38}

The last two propositions are particularly weighty given that so much of the criticism directed at the antitrust laws over the past four decades has pertained to the overdeterrence that results from a system that rewards private plaintiffs with treble damages plus attorneys fees and costs.\textsuperscript{39} When the FTC is explicitly reaching beyond the Sherman Act in order to condemn anticompetitive conduct, subsequent private overdeterrence based on these actions should not be an issue.

III. ADDRESSING LACUNAE IN ANTITRUST COVERAGE?

I believe there is serious merit to many of these propositions. The FTC should expand its reach to bring in some conduct that does not fall within the coverage of the Sherman and Clayton Acts as currently interpreted by the Supreme Court. In doing so, however, the FTC needs to be mindful of one thing that often eluded it in 1960s-era decisions such as \textit{Brown Shoe}; namely, the practices that it condemns must really be “anticompetitive” in a meaningful sense. That is, there must be a basis for thinking that the practice either does or will lead to reduced output and higher consumer prices or lower quality in the affected market. Expansive readings of the FTC Act should not unreasonably blur the line between competition concerns and consumer protection concerns; and most importantly, consumers—and not competitors—must be the ultimate protected class.

With that, I offer a few observations, as well as some examples from both past and present FTC actions.

\textbf{A. Attacking Monopoly in its Incipiency}

\begin{itemize}
  \item damages, including “disgorgement” of improperly obtained monopoly gains. \textit{E.g.}, FTC \textit{v. Mylan Labs., Inc.}, 62 F. Supp. 2d 25, 36–37 (D.D.C. 1999) (disgorgement); \textit{see also FTC, Policy Statement on Monetary Equitable Remedies in Competition Cases} (approved July 25, 2003), http://www.ftc.gov/os/2003/07/disgorgementfrn.htm. In addition, the FTC has issued some mandatory orders, such as for compulsory licensing of patents. \textit{See, e.g.}, Charles Pfizer \& Co. \textit{v. FTC}, 401 F.2d 574, 585–86 (6th Cir. 1968); \textit{cf. FTC v. Febre}, 128 F.3d 530 (7th Cir. 1997) (affirming the ordering disgorgement of monies obtained through false or deceptive advertising).
  \item Cf. Posner, \textit{supra} note 24, at 766.
  \item \textit{See sources cited supra} note 38.
\end{itemize}
First, “incipiency” concerns are legitimate, provided that we really do mean “incipiency” and know the criteria of proof. The word “incipient” generally means something such as “starting to manifest itself.” The term is useful in antitrust analysis if it is limited to situations where monopoly or collusion really is in prospect and the tribunal is in a position to solve the problem. That is, it should function something like the “dangerous probability of success” requirement in the law of attempt to monopolize.\footnote{40}{Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 457-58 (1993); Swift & Co. v. United States, 196 U.S. 375, 396 (1905).}

Under that law, conduct by a firm that is not yet a monopolist can be condemned, but only if there is a “dangerous probability” that this conduct, if permitted to run its course, would result in the forbidden monopoly. In such cases, the social savings of identifying and condemning such conduct early can be considerable, just as they can be when the police intercept an incipient arsonist before—rather than after—he lights his match or when a doctor detects and treats cancer at an early stage. One of the problems of older FTC actions, such as the one against Brown Shoe, was that monopoly simply was not in prospect at all. What the FTC identified as unfair was nothing more than an efficient retail distribution system that made it more difficult for traditional, higher cost independent retailers to sell shoes.\footnote{41}{See generally FTC v. Brown Shoe Co., 384 U.S. 316 (1966). See supra text accompanying notes 20–22.} The beneficiaries were small independent retailers, clearly not consumers. Very likely, the practice would never have resulted in a monopoly of anything, although it might eventually have resulted in other shoe manufacturers attaining the same efficiencies by integrating vertically into retailing.

**B. Cartel-Like Behavior**

Second, there is serious theoretical promise to the notion that § 5 of the FTC Act can be used to reach collusion-like behavior that does not satisfy the “contract, combination, or conspiracy” provisions of § 1 of the Sherman Act. The Supreme Court and lower federal courts have been dealing with this issue for three quarters of a century. In its 1939 *Interstate Circuit* decision, an action brought under the Sherman Act by the U.S. Justice Department, the Supreme Court found an inference of an agreement supported by parallel conduct despite no evidence of actual communication among the firms.\footnote{42}{Interstate Circuit v. United States, 306 U.S. 208, 225–26 (1939). For a recent application by the FTC, see Toys “R” Us, Inc. v. FTC, 221 F.3d 928 (7th Cir. 2000) (sustaining an FTC finding of unlawful collusive conduct).}

Significantly, the conduct in that case was in response to an explicit invitation from a buyer, and the Court concluded that compliance by each individual member would have been irrational except on the supposition that they were acting in concert.\footnote{43}{See 6 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1426 (3d ed. 2010).} The Supreme Court went even further in the *American Tobacco* case in 1946, holding that an agreement could be
inferred from parallel pricing behavior.\textsuperscript{44} Since that time, however, the
general trend of Supreme Court decisions has been more restrictive,\textsuperscript{45} and
some language in the 2009 \textit{Twombly} decision suggests that there must be
evidence of an actual time and place at which an illicit agreement
occurred.\textsuperscript{46}

One of the problems in addressing cartel-like behavior is a disjunction
between the language of the Sherman Act and the economic theory of
oligopoly. The Sherman Act’s “contract, combination or conspiracy”
requirement reflects a lawyer’s view of collusion and an essentially common
law conception that a cartel requires a contract or agreement in the
common law sense. Indeed, virtually all of the law of contracts in restraint
of trade prior to the passage of the Sherman Act involved explicit
agreements.\textsuperscript{47} In sharp contrast, economists tend to see collusion in the
language of “games,” or strategies, rather than agreements.\textsuperscript{48}

This economic theory has gone through considerable transition over the
years. Historically, it was strongly structural and saw a correlation between
performance, or pricing, in a market and such factors as the number of
firms, their size disparities, and entry barriers.\textsuperscript{49} Relying on this theory,
anti-trust policy makers once believed that concentrated industries, which
are markets that contain a small number of firms, were structurally
incapable of behaving anti-competitively.\textsuperscript{50} As a result, some proposed that
the firms in such markets should be broken up so as to increase the amount
of competition. Indeed, in the 1960s, Congress once entertained passing a
“concentrated industries” act that would have done so.\textsuperscript{51} However, with the

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{44} Am. Tobacco Co. v. United States, 328 U.S. 781, 809–10 (1946); \textit{see also} United States v.
Masonite Corp., 316 U.S. 265, 275–76 (1942); 6 \textsc{Phillip E. Areeda & Herbert Hovenkamp}, \textsc{Antitrust Law }\textsc{¶} 1427, 1433b (3d ed. 2010).
\item \textsuperscript{45} \textit{E.g.}, Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 582–86 (1986)
(refusing to find a conspiracy from parallel behavior when other evidence suggested that the conspiracy
was implausible).
\item \textsuperscript{46} Bell Atl. Corp. v. Twombly, 550 U.S. 544, 565 n.10 (2007); \textit{see also} William H. Page,
\textit{Twombly} and \textit{Communication: The Emerging Definition of Concerted Action Under the New
Pleading Standards}, 5 \textsc{J. Competition L. & Econ.} 439 (2009); \textit{see generally} Herbert Hovenkamp,
\textit{The Pleading Problem in Antitrust Cases and Beyond}, 95 \textsc{Iowa L. Rev. Bull.} (forthcoming 2010)
(discussing Twombly’s requirement to plead all essential facts with specificity).
\item \textsuperscript{47} \textit{See generally} Herbert Hovenkamp, \textsc{Enterprise and American Law}: 1836-1937, chs.
20–21 (1991); Herbert Hovenkamp, \textit{The Sherman Act and the Classical Theory of Competition}, 74
\textsc{Iowa L. Rev.} 1019, 1029-1041 (1989).
\item \textsuperscript{48} \textit{See 6 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law }\textsc{¶} 1428–36 (3d ed.
2010); W. Kip Viscusi, Joseph E. Harrington, Jr. & John M. Vernon, \textsc{Economics of Regulation}
and \textsc{Antitrust} ch. 6 (4th ed. 2005).
\item \textsuperscript{49} For a history of the theory and its relevance to antitrust policy in the United States, see
Herbert Hovenkamp, \textit{United States Competition Policy in Crisis}, 1890-1955, 94 \textsc{Minn. L. Rev.}
311 (2009).
\item \textsuperscript{50} Donald F. Turner, \textit{The Definition of Agreement Under the Sherman Act: Conscious
Parallelism and Refusals to Deal}, 75 \textsc{Harv. L. Rev.} 655, 663–64 (1962); \textit{see generally} Carl Kaysen
& Donald F. Turner, \textsc{Antitrust Policy} 110–19(1959). Turner was head of the Antitrust Division
from 1965 to 1968.
\item \textsuperscript{51} The provision was proposed in the Neal Report, which was commissioned by President
\end{itemize}
\end{footnotesize}
rise of the Chicago School, the theory of oligopoly behavior de-emphasized structure as such and began to look more at conduct, particularly at “facilitating practices” that might make markets more conducive to cartel-like behavior. 52 Within that theory two things are true: first, one does not need explicit communication or even an “agreement” in the common law sense to produce interdependent action; and second, the nonexistence of actual communication is not necessarily a good indicator of the dividing line between pro- and anticompetitive agreements. Indeed, communication may be an indicator that methods of coordination that do not require communication are ineffective because the industry is excessively prone to competition.

Responding to these developments in economic theory, the FTC has attempted to use § 5 of the FTC Act to pursue collusion-like activity. More particularly, the Commission has sought to obtain cease and desist orders against “facilitating practices,” whether developed by explicit agreement or not, such as delivered pricing, which creates cartel-facilitating homogeneity among sellers, or various practices that tend to make prices stick, 53 thus making price cuts more difficult. Among these are so-called most-favored-nation clauses, which require price cuts to be given retroactively to previous customers, 54 and systematic use of advance price announcements, or delivered pricing or basing-point pricing provisions that eliminate competition on the basis of location. 55 In addition to looking at particular practices, the FTC is also in a position to use statistical analysis of pricing patterns or buyer-seller alignments that can provide evidence of collusion.

These efforts have frankly not been met with a great deal of success, but I do not believe they should be abandoned. Indeed, there are a large number of advantages to using the FTC to pursue collusion-like behavior. First is the obvious one that the “unfair methods of competition” formulation in the FTC Act does not contain an explicit agreement requirement. Then, there is always the fact of agency fact-finding expertise. Third are limitations on private actions and remedy.

A significant problem of pursuing collusive behavior in ambiguous


53. E.g., E.I. DuPont de Nemours & Co. v. FTC, 729 F.2d 128, 139–42 (2d Cir. 1984); Boise Cascade Corp. v. FTC, 637 F.2d 573, 581 (9th Cir. 1980) (delivered pricing).

54. Dupont, 729 F.2d at 130, 142.

55. Boise, 637 F.2d at 575.
situations is false positives. Although overcharge damages are difficult to prove, the threat of treble damages suits could serve to deter precompetitive conduct. The least costly way to pursue facilitating practices or collusion-like behavior in the absence of explicit evidence of agreement is for the FTC to identify anticompetitive practices and then condemn them with cease and desist orders. In that case, the social cost of a false positive is the loss of the market’s ability to employ the practice that has been enjoined. For example, basing point or delivered pricing might be collusive, but it might also be competitively harmless. An injunction against it will do no more than force the firms to adopt some alternative practice, and firms are generally quite adept at doing this. The caveat, of course, is that the order itself must not be anticompetitive.

C. Conduct Analogous to Abuse of Dominant Position

Third, expanding FTC authority could reach negative actions outside a firm’s primary market, which is sometimes called the “monopoly leveraging” theory in U.S. antitrust law. Beginning with the Griffith decision in 1948 and famously reiterated by the Second Circuit in its Berkey Photo decision in 1979, some courts have suggested that a firm that has monopoly power in one market might use that power to attain a competitive advantage or cause consumer harm in a collateral market even if the tribunal cannot establish monopolization of the second market. In its 1992 Kodak decision, the Supreme Court indicated that it might still adhere to such a theory, but a year later, in Spectrum Sports, it largely rejected the theory and reiterated that rejection in the Trinko case in 2004. Today, it seems quite clear that § 2 of the Sherman Act does not contemplate a monopoly leveraging claim. However, European competition law is to the contrary. Article 82 does not require

59. Id. (approving, in principle, the proposition that “the use of monopoly power attained in one market to gain a competitive advantage in another is a violation of § 2, even if there has not been an attempt to monopolize the second market. It is the use of economic power that creates the liability”).
60. Eastman Kodak Co. v. Image Tech. Servs., 504 U.S. 451, 479 n.29 (1992) (“The Court has held many times that power gained through some natural and legal advantage such as a patent, copyright, or business acumen can give rise to liability if ‘a seller exploits his dominant position in one market to expand his empire into the next.’” Id. (external citation omitted).
61. Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 459 (1993) (“The concern that § 2 might be applied so as to further anticompetitive ends is plainly not met by inquiring only whether the defendant has engaged in ‘unfair’ or ‘predatory’ tactics.”).
63. See 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 652 (3d ed. 2007).
“monopolization” but rather “abuse . . . of a dominant position.”\footnote{64} This formulation clearly contemplates conduct by which a monopolist takes unreasonable advantage of its position in one market in order to cause competitive harm in a second market. Such rules can be particularly important in dominated networks, which are markets that have stringent compatibility, or interoperability, requirements but that also have dominant firms.

A case in point is the most recent European decision ordering Microsoft to share server protocols with rivals.\footnote{65} Even if Microsoft’s actions did not create a monopoly in the server market, they considerably reduced ex ante incentives to invest. The record showed that independent developers had entered and opened the third-party market for email and internet servers first, using server operating systems that were compatible with Windows, which was installed on the computers attached to the network. Later on, however, Microsoft entered the server market itself and then began withholding technical information necessary to make rival servers fully interoperable with Windows. The result was to place the rival providers at a substantial disadvantage to Microsoft’s own servers. Independent firms wishing to invest in network markets that are dominated by a single firm need to have some assurance that, once their investment succeeds, the dominant firm will not capture it from them.\footnote{66}

Once again, the open ended “unfair methods of competition” language

\begin{itemize}
  \item Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:
  \begin{itemize}
    \item (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
    \item (b) limiting production, markets or technical development to the prejudice of consumers;
    \item (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
    \item (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
  \end{itemize}
\end{itemize}

\footnote{64}{Treaty Establishing the European Community art. 82, Nov. 10, 1997 O.J. (C340) 3.}

\footnote{65}{Case T-201/04, Microsoft v. Comm’n, 2007 E.C.R. II-1, paras. 30, 47–48 \footnote{available at http://curia.europa.eu/jurisp/cgi-bin/gettext.pl?lang=en&num=79929082T19040201&doc=T&ouvert=T&sequence=ARRET (finding that Microsoft controlled both primary operating system and software for its own servers and requiring Microsoft to share protocols with rivals who provided competing server software).}}

\footnote{66}{See Herbert J. Hovenkamp, \textit{The Obama Administration and Section Two of the Sherman Act}, 91 B.U. L. REV. ____ (2010).}
of the FTC Act would permit recognition of an action akin to “abuse of dominance” under European law. Of course, that is not the same thing as saying that such actions are good policy. Conduct in a secondary market that falls short of threatening monopoly there can be competitively harmful, but the harm to competition must be apparent.

Once again, limiting such actions to a regulatory agency such as the FTC seems sensible. In a network market such as the one where Microsoft operates, spillovers into collateral markets are very common and some injury is inevitable. Permitting private plaintiff actions could greatly increase the cost of operating such networks. The prosecutorial discretion of an agency rather than private incentives seems better suited to confine enforcement to truly serious situations, and the remedial limitation to a cease and desist order will limit the cost of false positives.

IV. THE FTC ACT AND THE INTEL CASE

One recent FTC complaint has been widely touted as an opportunity for the Commission to interpret § 5 of the FTC Act more broadly than the Sherman Act. That is the action brought against Intel, mainly for injuries in the market for microprocessors (CPUs) and graphics processors (GPUs) for desktop and laptop computer operating systems.67 The complaint is wide ranging and covers a number of practices, including so-called loyalty discounts, bundled discounts, cajoling customers into staying exclusively with Intel as a supplier, giving of false information concerning Intel microprocessor performance, designing a software compiler in such a way as to retard the performance of rivals’ processors, and other practices. The relief that the FTC requests is equally far ranging, and much of it is consistent with the recommendations offered here. For example, the FTC alleges that Intel induced various firms to develop technology along certain paths and then later denied interoperability between that technology and Intel’s CPUs.68

A. The FTC’s Substantive Case Against Intel

I want to focus briefly on the claims concerning Intel’s pricing and

67. Complaint at 2, In re Intel Corp., No. 9341 (FTC Dec. 16, 2009), available at http://www.ftc.gov/os/adjpro/d9341/091216intelcmpt.pdf (to the extent it is relevant, the author was consulted by Intel in a prior proceeding before the Korean Fair Trade Commission in 2007). Increasingly, GPUs are being used as substitutes for CPUs. As a result, GPU development threatens Intel’s CPU market share. Intel’s principal competitor in the GPU market is Nvidia. Intel’s share of the CPU market is alleged to be 75%–85% with revenues consistently exceeding 80%. See id. at 2. Its share of the GPU market is alleged to be in excess of 50%. See id at 3–4. “Compilers” are programs that turn source files, written in human-readable programming language, into machine-executable files. See Bjarne Stroustrup, The C++ Programming Language, 197–98 (3d ed. 2003); Reiffen v. Microsoft Corp. 214 F.3d 1342, 1344 (Fed. Cir. 2000) (describing function of compilers). Under appropriate circumstances, product designs created so as to degrade rivals’ products without improving one’s own violate § 2. See, e.g., C.R. Bard, Inc. v. M3 Sys., Inc., 157 F.3d 1340, 1369–72 (Fed. Cir. 1998).

68. Complaint, supra note 67, at 4.
discount practices and, in particular, on the particular forms of relief the FTC is seeking. The FTC’s contemplated relief may lead the FTC down the same unfortunate road it travelled in the 1970s and earlier, when the FTC condemned practices that really were not anticompetitive. In the process the actions benefitted competitors but caused consumers more harm than good.

Loyalty discounts, or rebates, are discounts that a customer can obtain by sticking with a particular supplier. For example, a manufacturer might agree with a customer that the price of a product is $100 per unit but that the customer will get a 10% rebate at the end of the year if it purchases at least 80% of its needs of this product from the seller rather than a competitor. Sometimes the discounts are staged, such as a 10% discount if one purchases 90% of its needs, or a 5% discount if one purchases 80% of its needs. Loyalty discounts can have two quite different effects. First, they can make it more difficult for rivals to compete, given that the discounted price is lower than the full price. Second, they tend to increase the discounting seller’s output by guaranteeing more sales to each customer made subject to the discount plan. Exclusion can be a bad thing under some circumstances, but output increases are typically a good thing. The problem is sorting them out.

First, it is important to distinguish between above-cost and below-cost discounts. No one makes money in the long run by selling something at below cost, so a discount that drives the price of a product below its cost must have an explanation. Below-cost discounts can be intended to drive rivals out of the market so that the dominant firm can then raise its price to monopoly levels. Some of the allegations in the FTC’s complaint are that Intel engaged in below-cost discounting with the probability that it could later recoup any losses that it suffered.69

However, what the complaint means by “below cost” discounts is not entirely clear. The references to costs in the complaint appear to be to “bundled” discounts and may mean no more than that one of the products in the bundle is priced at less than the cost of that particular product. But many bundled sales contain a “below cost” component in this sense and are nevertheless well above cost when one considers the entire bundle. For example, if a car dealer offers a price with a $1,000 markup and then tells a reluctant customer that she will add in a $400 stereo for $300 more, one might say that the price of the stereo is “below cost.” However, the automobile manufacturer is still earning $900 on the package of car and the stereo.70 Further, the dealer is unlikely to sell the stereo for $300 without the car, which would be a below-cost sale. In such circumstances, one expects to see both dominant and nondominant car dealers selling cars without the stereos when they are able to and selling them with the stereos, or some equivalent, when they have hard-bargaining customers. Both sets of sales are profitable, although the first group is more profitable than the

69. Id. at 4–5.
70. On the analysis of such bundled discounts, see 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 749 (3d ed. 2007).
second. That is how competitive markets work; the strategy increases the car dealers’ sales and their profits without excluding anyone.

In another part of the complaint, the FTC accuses Intel of selling to some customers at a price that might be sufficient to cover its variable cost but not its fixed, or sunk costs. However, once fixed costs have been incurred, any price above variable—or production—costs is generally profitable, and costs per unit go down as output goes up. If condemning such pricing is what the FTC has in mind, then it may end up condemning procompetitive behavior.

The FTC’s Notice of Contemplated Relief appears to prohibit some above-cost loyalty discounts. This could invite a clash with the Sherman Act. At least since the early 1990s, the Supreme Court has been extremely restrictive in its treatment of above-cost pricing policies, repeatedly holding that prices cannot be unlawful under the antitrust laws unless they are below some measure of cost. This was true of orthodox predatory pricing in the Brooke Group decision in 1993, again, more recently, of alleged predatory buying in the Weyerhaeuser decision, and of the so-called price squeeze in the linkLine decision. Taken together, these decisions strongly indicate that the Supreme Court will not permit §2 of the Sherman Act to be used to condemn pricing policies where the prices are above cost, and that is how most lower courts, as well as the FTC in some cases, have interpreted them.

---

71. Complaint, supra note 67, at 9. A sunk cost is one that has been invested up front and that cannot be recovered. For example, research and development costs leading up to production of a microprocessor are typically sunk costs. Some fixed costs are not sunk; for example, 100 acres of farmland is a fixed cost for the farmer because his or her mortgage must be paid whether or not the farmer grows anything on the land. However, the investment is typically not a sunk cost because the farmer can recover the investment by reselling the land.


76. Brooke Group Ltd. was a Robinson-Patman Act suit, but the Supreme Court made clear that it was applying Sherman Act principles. 509 U.S. at 219–20, 221.

77. E.g., Doe v. Abbott Labs., 571 F.3d 930, 934-35 (9th Cir. 2009) (bundled discounts); Cascade Health Solutions v. PeaceHealth, 515 F.3d 883, 901 (9th Cir. 2008); Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039, 1059–63 (8th Cir. 2000) (requiring that loyalty discounts be below cost to violate the Sherman Act). The FTC itself has noted the problem in pricing cases. See, e.g., In re General Foods Corp., 103 F.T.C. 204 (1984), where the Commission refused to condemn alleged predatory pricing in a competitively structured market, concluding that while its own powers went beyond those of courts, it was not wise to disregard structural requirements that the courts had imposed in predatory pricing cases:

The proscription against attempted monopolization in Section 2 of the Sherman Act does not require a showing of monopoly power or injury to competition—a dangerous probability is sufficient. We do not believe this standard should be changed when a case is brought under Section 5. To distinguish between an attempt to monopolize and an incipient attempt on the basis of potential market power is to engage in such fine distinctions as to challenge the legal philosopher, let alone the
Arguments have been made that above-cost loyalty discounts can be anticompetitive because they tend to exclude firms with higher costs or deprive them of economies of scale that would permit them to compete at the same level. However, most U.S. courts have rejected those arguments on grounds of both practicality and principle.

As a matter of practicality, economies of scale are notoriously difficult to measure, and it is virtually impossible to proclaim a particular rate of output as one where all scale economies have been exhausted. As a matter of principle, a contrary rule turns the dominant firm into a watchdog, limiting its own sales in order to protect rivals who may have higher costs; indeed, in some cases, it may even require a firm to develop information about its rivals’ costs or else risk antitrust liability. Further, a rule condemning above-cost pricing under the Sherman Act would invite countless lawsuits from competitors unhappy about a dominant firm’s aggressive pricing.

To be sure, the FTC has some of the same advantages here as in other areas. It may be a more accurate fact finder, and we would not have to worry about dozens of follow on private plaintiff cases claiming that above-cost discounts are anti-competitive. But the problem remains that we want firms to compete hard, and each firm knows its own costs far better than it knows the costs of rivals. Forcing firms to charge higher prices in order to protect less efficient rivals produces immediate consumer harm; so a tribunal that is going to condemn such a practice must be dead certain that it will not be doing more harm than good.

B. The FTC’s Requested Remedies

While the FTC’s Notice of Contemplated Relief in the Intel case contains some ambiguity, it seems to contemplate the elimination of many above-cost discounts and to force the firm to raise prices to levels clearly in excess of variable costs, explicitly including a fixed cost component. However, the complaint does not indicate how this component will be measured. Orders of this type will lead immediately to higher prices. Whether they are predictably competitive in the longer run because they permit competitors to survive or even enter is a different question, and

competitor trying to conform its conduct to the law. If the conduct at issue here cannot reach the early threshold of doubt under the Sherman Act, we will not condemn it under the Federal Trade Commission Act.

_id_ at 365–66; _see generally In re Borden, Inc._, 92 F.T.C. 669 (1978) (condemning pricing policies where at least some of the prices were above average variable cost).


answering it requires extraordinary knowledge of the situation and predictive skill.

There are probably very good and precompetitive reasons for Intel’s loyalty discount practices, although not for all of the practices alleged in the FTC’s complaint. Microprocessors are products that are characterized by high up-front development costs, accompanied by relatively low production costs. Further, the life of a particular microprocessor is limited because obsolescence occurs so quickly, often within two or three years after a chip is introduced. The “refresh cycles” that occur whenever the need for a new processor chip arises gives rivals an opportunity to bid anew for a particular buyer’s business and to offer discounts or rebates similar to or more aggressive than Intel’s. The opinion in the European Union’s recent action against Intel found that these refresh cycles are typically less than a year. 80

The fact of high fixed costs means that the total cost of producing microprocessors is exceptionally sensitive to the volume of chips that are produced during that chip model’s product life. To illustrate, suppose that development costs of a particular chip are $100 and production costs are $1 per chip. If such a firm were to sell ten chips, total costs would be $10 for fixed costs, plus $1, for a breakeven price of $11. If the firm were to sell 20 chips the minimum price would be $6. And if it were to sell 100 chips the breakeven price would be $2, that is, $1 per chip to cover fixed costs and $1 to cover production costs. In short, a guarantee of higher volume permits the firm to offer vastly lower prices over the chip’s lifetime. But the seller must typically bid out the price for most of the chips sold at the beginning of each demand cycle. The greater the output it can confidently predict, the lower a price it can afford to bid.

This set of facts gives a kind of quasi-natural monopoly quality to a microprocessor chip with a given set of performance characteristics. It would be cheaper for one firm to produce the entire production run than it would be for two firms innovating separately to develop competing chips. That result is at least somewhat borne out by the competitive history between Intel and AMD. While the two firms are clearly competitors, they tend to make chips with different capabilities and designed for different market niches. Indeed, the two firms compete by differentiating their products much more than casual buyers think, even though, at a general level, they are said to be compatible with one another.

Intel, as a chip seller bidding an upfront price, faces two sets of risks. 81 One is the risk of a general market downturn, which will reduce chip demand. The other is the risk that the buyer, having a firm contract price, will shop the contract around and get a little lower price elsewhere.

A seller like Intel can improve the attractiveness of its package if it bears the first type of risk—that is, the market risk—itself. This is why it tends to


81. Id. para. 1019 (noting unreliability of predictions).
use market share discounts rather than quantity discounts. A quantity discount attaches to a specified number of chips, and if the market becomes weak and the computer maker’s sales fall below that number, the computer maker must pay the higher price. By contrast, a market share discount attaches to, say, 90% of the buyer’s sales, whatever they happen to be. So the market share discount offers the computer maker the lower price, even if the market becomes weak, provided that the computer maker purchases its requisite percentage of chips from the seller.

Risks that the chip buyer will try to get other sellers to undersell the contract are a different matter. This behavior is completely within the control of the computer makers, and Intel cannot bid a price whose profitability depends on a high volume of sales unless it can be assured that this high volume will materialize. Further, it knows that its purchasers are rational maximizers of their own profits as well. As a result, Intel predicts that, if given the opportunity, the buyers will ditch the dominant firm’s contract in order to get a lower price elsewhere if they are able to. If Intel’s price includes a significant fixed cost component, as it must if the overall price is to be profitable, then a rival will be able to bid a lower price on a chip it is already producing. As long as that price is above average variable cost, it will be profitable to the rival and will steal Intel’s sales. The customer will then end up purchasing a far lower number of chips than Intel initially contemplated. The loyalty discount serves both to penalize the behavior and to force the customer to share part of the cost to Intel of reduced chip sales that result from the customer’s own choice.

These facts can be particularly problematic if one looks at the relief that the FTC is requesting in its complaint. The complaint requests that Intel be forbidden from using “threats, bundled prices, quantity discounts, and other offers to encourage exclusivity or to deter competition or unfairly raise the price of its microprocessors . . .” with a presumption that a discount condition reaching more than 60% of a reseller’s historical purchases is anticompetitive.82 The order may also prohibit Intel from requiring customers to “purchase a minimum or fixed volume or percentage of the customer’s overall . . . requirements from Intel (regardless of whether such fixed percentage relates to a product line for customers with multiple product lines or on a company-wide basis)[].”83

The suggested relief also requires Intel to set its prices above its costs, with “cost” defined to include an unspecified amount, or “multiple,” of fixed costs as well as all variable costs.84 Exactly how this portion of the

---

82. Complaint, supra note 67, at 19.
83. Id.
84. See id. at 21. The mandate reads:

Prohibiting Intel from pricing its microprocessors so that the incremental price to a customer of microprocessors or GPUs sold in competition with another competitor is below cost when such price includes all rebates, payments, or other price decreases on other products not in competition. Pricing will be presumed to be below cost even if it exceeds Intel’s average variable cost but does not contribute to its fixed sunk costs in an appropriate multiple of that average variable cost. Pricing or sale of kit or
relief would be implemented is unclear. However, once fixed-cost investments have been sunk, a firm typically profits by making any sale it would otherwise forego where the price is higher than incremental or variable cost. The more the firm sells, the lower the fixed costs will be on a per unit basis. This behavior has nothing to do with monopoly and is a fundamental ingredient in firm rationality. For example, a highly competitive small airline knows that if the additional costs of carrying an extra passenger in an otherwise empty seat are $50, any price higher than $50 will contribute to the carrier’s bottom line. It does not matter that the price is insufficient to cover a per seat allocation of the cost of the mortgage on the plane or the firm’s real estate or even the pilot’s salary.

As a result, tiered pricing is common among both dominant and competitive air carriers, and the key to competitiveness and profits is higher total output. In sum, requiring a firm to include a government-mandated “multiple” of fixed costs in addition to variable costs in its bid price is to force it to behave irrationally. Indeed, it would make it likely that Intel would lose any bid against an equally efficient competitor simply because it was unable to bid its lowest profitable price.

The proposal that Intel not be permitted to offer discounts tagged to purchases exceeding 60% of a purchaser’s historical needs recalls fact findings in the European Intel decision, which distinguished between the “noncontestable” and “contestable” portions of Intel’s output to any given customer. The logic of this analysis is, while an equally efficient rival can ordinarily match any above-cost discount, it may not be able to match the lost discount on that portion of a customer’s purchases that are noncontestable; that is, those portions that the customer must purchase from Intel no matter what. For example, if the noncontestable portion of sales to some customer is, say, 60%, then the firm that wants to match a discount that requires a 90% purchase is not going to be able to sell this firm more than 40% of its needs in any event. Further, it must not only match the discount on the number of chips that it is able to sell, but it must also compensate the customer for the foregone discount on the chips that it is not able to sell, and for which the customer, having lost the discount,

bundled products will be presumed to be above “cost” if the “kit” or “bundle” includes an x86 product or, if it does, if, after all discounts have attributed to the competitive product(s) in the bundle, the resulting pricing is well above Intel’s average variable cost plus a contribution to Intel’s fixed sunk costs in an appropriate multiple of that average variable cost.

Id.

85. The social efficacy of this kind of pricing has been well known in price theory for well over a century. See John Maurice Clark, Studies in the Economics of Overhead Costs (1923); see generally Herbert Hovenkamp, Regulatory Conflict in the Gilded Age: Federalism and the Railroad Problem, 97 Yale L.J. 1017 (1988) (noting how railroad shippers charging lower rates for larger shippers reflected the lower costs of selling in larger volumes—not price discrimination). On the current law, mainly in the context of predatory pricing cases, see Areeda & Hovenkamp, supra note 70, ¶¶ 736–37, 742.

86. Intel Commission Decision, supra note 80, paras. 1255–59 (discussing Dell’s incontestable share of Intel purchases).
must now pay the higher price.87

The analysis of such deals is similar to that for bundled discounts, where the rival makes only one of the two products in the bundle. The European Commission condemned Intel’s discounts of this type under an “attribution” test roughly analogous to the one that has been applied in some U.S. courts for bundled discounts. The test works something like this: Suppose that, because Intel is dominant in the industry, a computer manufacturer needs to purchase at least 50% of its chips from Intel; the rest it might be able to get from competitors. However, Intel uses a market share discount scheme that gives the computer maker a discount only if it purchases 90% of its chips from Intel. In that case, if the firm wanted to purchase as much as, say, 25% of its chips from a rival, it would lose the discount on the 50% of the “noncontestable” chips; so the rival would not only have to match Intel’s discounted price on the chips actually sold to the rival, but it would also have to compensate the customer for the lost discount on the 50% of noncontestable chips. On these hypothetical numbers, it would take a discount three times bigger than Intel’s discount for the rival to take the sale.88 The attribution test “attributes” the discount on all units to the sales that the rival is able to make and then considers whether the size of this discount is so large that it would drive the effective price below cost.89

The test is critically dependent on a finding that a specific percentage of Intel’s output is noncontestable, and a few points variation can make the test come out differently. Further, the question whether any output is contestable is very sensitive to price. That is, Intel cannot charge an infinitely high price even for the noncontestable portion of its output; rather, it is contestable only in the sense that at a given price the computer manufacturer has a strong preference for Intel chips over the alternatives. Further, depending on how the FTC’s proposed remedy is applied, it may put Intel in a position of not being able to bid more aggressively for the “contestable” part of its output than for the “noncontestable” part.90 Once a firm’s fixed cost investment has been made and sales are underway, any sale

---

87. For example, suppose a customer’s “noncontestable” share of purchases from the dominant firm is 60%, and the dominant firm gives a 10% discount to whoever purchases at least 90% of its needs from it. A rival has the same costs and would like to bid for the 40% of contestable demand, but it would also have to compensate the customer for the lost 10% discount on the 60% of incontestable purchases. Effectively, it would have to give a 25% discount, assuming that it could then capture the entire 40% of contestable purchases.


90. Perhaps Intel could tell buyers that if they take the incontestable portion of their output from Intel at, say, $100 per unit, it will sell them additional units at $90; but this would still look like a discount conditioned on the buyer taking a minimum market share from Intel.
of an additional unit at a price above average variable cost is profitable to the firm. Further, this rule applies even if a certain range of output is incontestable. Having sold those units at the market price, incremental sales at any price above incremental cost are rational. An order forcing Intel to charge more will be difficult to administer, will force Intel to avoid putting low-cost output on the market, and will be unlikely to increase competition. Further, it ignores the basic economic truth that price discrimination is virtually inevitable and typically procompetitive in markets with high fixed costs.91

One possibility that the FTC must consider is that a remedy that forbids Intel from competing aggressively will produce duopoly or collusion rather than competition. I noted before that the social cost of false positives in cease and desist orders can be less than the cost of substantial treble damages actions.92 But this limitation does not apply to every cease and desist order, and some might do more harm than good by facilitating collusion or collusion-like behavior.93 In this case, and at least in the CPU market, once Intel is forbidden from taking advantage of above-cost discounts or engaging in aggressive pricing, it may very well reach a comfortable equilibrium with its rival AMD, which will give both firms good profits and no incentive to deviate downward. This is not a prediction that price fixing will occur but simply an observation that in a two-firm market with high fixed costs, the firms will tend to track each other’s output and pricing. The result could be that they reach a relatively stable price level that is well above their costs, at least until a new entrant forces them to compete harder. In that case, the goal of turning AMD into a

91. When fixed costs are high, market share or quantity discounts can serve a purpose similar to that of two-part tariffs, which approach more efficient output by using one price component to represent an allocation of fixed costs and the other variable costs. For example, a firm with $100 in upfront fixed costs and $1 in variable costs might charge customers a $10 fee to cover a pro rata share of fixed costs and $1 in per unit costs. In that case, a customer who bought 10 units would end up paying $2 per unit; one who bought 50 units would end up paying $1.20, etc. That is, the more the customer purchased, the less it would pay on a per unit basis. Indeed, two-part tariffs are often implemented by the offering of a number of alternative “bundles” whose per unit price varies inversely with the number of units that the customer purchases. See Jean Tirole, THE THEORY OF INDUSTRIAL ORGANIZATION 143–49 (1988); see generally Sreya Kolay, Greg Shaffer & Janusz A. Ordover, All-Units Discounts in Retail Contracts, 13 J. ECON. & MGMT. STRATEGY 429 (2004) (discussing how large-volume discounts create more profit than the typical two-part tariffs); Patrick Greenlee, David Reitman, & David S. Sibley, An Antitrust Analysis of Bundled Loyalty Discounts 10–11 (U.S. Dep’t of Justice Econ. Analysis Group, Working Paper EAG 04-13, 2004), available at http://www.justice.gov/atr/public/hearings/single_firm/docs/220345.htm; Bruce H. Kobayashi, The Economics of Loyalty Discounts and Antitrust Law in the United States 5 (George Mason Univ. Law & Econ., Working Paper Series, No. 05-26), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=794944.

92. See discussion supra p. 24.

93. A well known example is FTC v. A.E. Staley Manufacturing Co., 324 U.S. 746 (1945), where the Supreme Court upheld an FTC order that effectively required one firm to investigate into a competitor’s prices in order to qualify for the Robinson-Patman Act’s “meeting competition” defense. Id. at 758.
profitable competitor will have been achieved but at consumers’ expense. The GPU market has more rivals, including AME as well as Nvidia, but, even here, an order forcing the largest producer to hold its prices above its optimal level may end up doing more harm than good.

V. CONCLUSION

There are good reasons for the Commission to use § 5 of the FTC Act to reach more broadly than the Sherman Act has reached, and the reasons pertain to both procedure and substance. But when § 5 is used to further competition policy, it must not be interpreted so as to undermine competition goals, which are high output of high quality products and low consumer prices. One reading the Intel complaint fears that the FTC is on a course toward the same set of mistakes that it made in the 1960s, when it used § 5 to protect rival businesses at consumers’ expense.

To be sure, this complaint contains allegations that go beyond Intel’s market-share discounts, including claims of untruthful behavior about the performance of Intel’s products, calculated to induce customers to stay with Intel rather than going to a rival. These may well deserve condemnation, although it is not obvious that application of § 5 of the FTC Act is necessary. For example, the government’s Sherman Act case against Microsoft included claims of untruthful statements made to software developers in order to shore up Microsoft’s position by convincing the developers that their products would work with any operating system when it in fact worked only with Microsoft Windows. The court had no difficulty condemning these claims under the Sherman Act when the necessary connection between the conduct and Microsoft’s market dominance was established. If the FTC is proceeding as an antitrust enforcer, whether under the Sherman Act or the FTC Act, it must show that the deception, in some way, contributed to the creation or maintenance of monopoly power. Of course, the FTC can also proceed against fraud in its consumer protection role, and in that case, it can obtain an injunction against deceptive conduct without showing a link to monopoly.

At this stage, the FTC deserves the benefit of the doubt. Complaints are invariably drafted broadly, and the issues and scope of relief narrow during the adjudication process. That will, undoubtedly, happen in the Intel case as well. But the opportunity to take advantage of its special status in order to make good, consumer-regarding antitrust policy is one that the FTC should not lose. An injunction against practices that are clearly exclusionary and have little social value is one thing, but an order requiring Intel to refrain from bidding aggressively for additional sales in the way that any rational firm would is likely to benefit mainly Intel’s rivals at consumers’ expense.

95. Id. at 77–78.