

ARTICLE

A Riff and a Half on the Delineation of Relevant Markets in Antitrust Cases

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Introduction

The delineation of relevant markets is a too-often neglected area of antitrust discussion. It is boring. It is infrastructure. It is technical. And it is often treated as secondary or tertiary – if it is discussed at all. In his recent (May 18) Milton Handler Lecture for the New York City Bar Association, Assistant Attorney General for Antitrust Jonathan Kanter stressed that what’s important for antitrust is preserving competition and the competitive process. AAG Kanter was silent on the question of relevant markets or their delineation.

But competition takes place in markets. And efforts to preserve competition – whether with reference to mergers that might significantly reduce competition or with reference to unilateral exclusionary or restrictive actions that may have already significantly reduced competition (or might do so going forward) – must have a context for evaluating those threats to and/or impingements on competition. There must be a *relevant market* for these evaluations. Otherwise, how can the concept of *market* power or *market* shares have any meaning?

In this note, I wish to make two points. First – and most important: A satisfactory paradigm for delineating relevant markets in unilateral monopolization cases – which involve allegations of restrictive, exclusionary, and/or predatory actions, or abuse of dominance – has not yet appeared in the litigation of monopolization cases. Unfortunately, the market delineation paradigm that has been successfully used for delineating relevant markets for antitrust merger analyses – the “hypothetical monopolist test” (HMT) – generally cannot be used for monopolization cases. But without a suitable paradigm, almost all such cases are doomed to devolve into a set of “he said, she said” claims by the litigating parties as to the relevant market, and

consequent judicial decisions will have little or no coherence with respect to this central aspect of these cases.

I will summarize here a market delineation paradigm for monopolization cases that I have recently developed; I believe that this paradigm provides the missing piece for these cases. But, in any event, the antitrust law and economics community needs to recognize the problem with respect to the actual litigation of monopolization cases – which the community has mysteriously thus far failed to do – and develop a solution.

My second point is more modest. As was mentioned above, the antitrust analysis of proposed mergers has benefited over the past 40 years (since the promulgation of the U.S. Department of Justice’s “Merger Guidelines” in June 1982) from a quite robust and widely accepted paradigm for delineating the relevant market. Although the paradigm applies equally well to “coordinated effects” theories and “unilateral effects” theories of merger harm, its actual application in the latter category of merger cases has often confused rather than clarified the relevant market for these cases. There is, however, a straightforward way to apply the paradigm to unilateral effects merger cases, which I will summarize here.

The Relevant Market in Monopolization Cases

A private plaintiff in a monopolization case usually claims that the defendant has engaged in restrictive, exclusionary actions that have disadvantaged the plaintiff (e.g., raised rivals’ costs) and thereby created and/or enhanced the defendant’s market power. (An enforcement agency in this kind of case will bring the claims on behalf of such disadvantaged parties, or on behalf of the consequently disadvantaged customers.) An important part of this claim is to demonstrate that the defendant currently possesses market power.

To this end, the plaintiff will typically argue that the defendant’s product is unique, that the defendant’s customers have little choice but to buy the product so as to address those customers’ special needs, and that the defendant thereby has substantial pricing discretion. The plaintiff will thus argue that the defendant’s product alone – or perhaps with a few similar but weak substitutes – constitutes the relevant market and that the defendant has a large market share of this relevant market.

For its part, the defendant will deny that its product is unique; the defendant will instead claim that the product has many substitutes to which consumers have and could readily turn – that the firm faces “fierce competition” and could not profitably raise its price above current levels. Hence, the defendant will claim that the relevant

market is far broader, and the defendant's market share is far more modest. And thus the defendant could not possibly be exercising market power.

This pattern of argumentation has been occurring since at least the 1950s when the Antitrust Division of the U.S. Department of Justice (DOJ) claimed that du Pont had monopolized the cellophane market (of which it had a 76% share) while du Pont claimed that the relevant market was "all flexible wrapping materials" (of which it had only a 20% share). A federal district court in 1953 – supported on appeal by a majority of the U.S. Supreme Court in 1956 – found in favor of du Pont. The Supreme Court's flawed reasoning in this case was soon characterized as "the *Cellophane* fallacy". (More about that below.)

A similar set of widely diverging claims by plaintiffs and by defendants in monopolization cases could be found in the DOJ's prosecution of Microsoft in the 1990s and is currently on display in the DOJ's suit against Google and the Federal Trade Commission's suit against Facebook.

So, what should be the basis for deciding whether the relevant market in a monopolization case is, say, cellophane or all flexible wrapping materials?

First, let us dispose of an argument that should not be used: the "it would be unprofitable for us to raise our current prices, so we must be in a broad market and our market share must be modest" argument. It was testimony of this type by du Pont executives at the *Cellophane* trial of the 1950s that convinced the federal district court judge and the Supreme Court majority that du Pont faced effective competition from other flexible wrapping materials and thus that the relevant market was broad – all flexible wrapping materials (and not just cellophane) – and that du Pont did not exercise market power.

However, as any "Microeconomics 101" textbook explains, every profit-maximizing enterprise – whether it is truly a monopolist that is selling a distinct product, or it is just one of many firms that are selling a near-perfectly substitutable commodity product – should be expected to set its price at a level where it would be unprofitable to increase the price to a higher level (because at the higher level the firm would lose too many current customers who would switch away to buying something else from someone else); this is the essence of the profit-maximization process. Thus, all profit-seeking enterprises should be expected to claim that they are unable profitably to increase their prices from current levels; and hence a statement of this sort is only – at best – a testament to the enterprise's profit-maximization efforts and should offer no guidance that could help an antitrust court determine a relevant market.

The district court's and Supreme Court majority's belief in the *Cellophane* case that the statement did offer guidance constituted the Court's "*Cellophane* fallacy".

Since then, over 60 years of legal and economics commentary has recognized and enshrined this error – but the error has been ignored and repeatedly appears when monopolization cases have been litigated.

But the typical plaintiff’s pleading in these cases warrants serious reconsideration as well. To the extent that plaintiffs claim that the defendant’s product is unique and faces few substitutes and (equivalently) that customers are “sticky” and unlikely to switch to other products, the direct inference must be that the defendant is currently not maximizing profits; the defendant ought to be taking advantage of these circumstances and maintaining a higher price. But that inference, in turn, throws into question the entire microeconomics intellectual structure on which modern antitrust rests. This is surely a dangerous line of argument for plaintiffs – especially enforcement agency plaintiffs – to pursue.

What about the HMT market delineation paradigm that has been successfully used for analyzing proposed mergers for 40 years? To delineate the relevant market, the HMT seeks to identify a group of sellers (generally the smallest number) that – if they *prospectively* were combined into a single firm (the “hypothetical monopolist”) – could successfully create or enhance market power and thereby bring about a “small but significant non-transitory increase in price” (SSNIP) from the current or otherwise expected price level.

This *forward-looking* question is appropriate for analyzing a *proposed* merger. But it cannot be used for analyzing whether an enterprise *currently* possesses market power – because all enterprises should be expected already to be at their profit-maximizing price. In essence, to use the HMT+SSNIP in this current monopolization context is just another commission of the “*Cellophane* fallacy”. (If, however, a *prospective* action – say, a *proposed* exclusive dealing arrangement – were at issue, then the use of the HMT+SSNIP paradigm would be appropriate.)

Perhaps evidence on the profitability of the defendant would be relevant? Or information about the defendant’s pricing? After all, the “Microeconomics 101” textbook always includes a diagram that shows that a monopolist earns profits that are higher than those that would be earned by an otherwise similar competitive industry, and the diagram also shows that the monopolist’s profit-maximizing price exceeds that firm’s level of marginal cost. But for decades economists have been wary of inferring anything from the reported accounting profits of companies. And the local coffee shop in any community or neighborhood likely charges prices that exceed its marginal costs; but few (if any) local coffee shops’ practices raise antitrust concerns.

What instead should be done? Since it is the plaintiff in such cases that bears the burden of proof, I will initially adopt the plaintiff's perspective in what follows: the analysis should shift the search for a relevant market away from the current pricing and outcomes, and, instead, should focus on a "but for" or counterfactual analysis. In the absence of – but for – the defendant's anticompetitive (exclusionary, restrictive, etc.) actions, the defendant's product would have faced much more competition, from a larger number of competing firms, which would have yielded lower prices and/or higher quality and/or a wider variety of products, etc. At the (counterfactual) lower prices, the defendant's product (and the cluster of competing products from the counterfactually competing firms) would be more distinct from the products with which (at the current higher prices) the defendant currently competes.

It is this counterfactual group of firms (including the defendant) that constitutes the *relevant market* for the purposes of considering the monopolization allegation. This is a market that can be monopolized (with higher prices, etc.) – as the defendant's anticompetitive actions have demonstrated. And this counterfactual basis for the delineation of the relevant market does provide an appropriate fit for the prospective framework of the HMT of the "Merger Guidelines".

Of course, this counterfactual scenario would need to be supported by appropriate modeling and by rigorous empirical data analysis.

What about the defendant's perspective? Let's assume that the discussion has gotten past the "we face fierce competition and can't currently raise our prices" claims. The defendant will, of course, assert an efficiency justification for its actions and will cast doubt on the plaintiff's modeling and empirical analysis, as well as asserting that the plaintiff's difficulties were of its own making and were not due to the defendant's actions.

As for a counterfactual scenario, the defendant might well assert that the market would look similar to its current structure – except that the defendant would be operating less efficiently (because of the absence of the defendant's actual actions). And, of course, this counterfactual scenario (and the defendant's aspersions of doubt as to the plaintiff's counterfactual) would need to be supported by appropriate modeling and by rigorous empirical data analysis.

There will still be "dueling economists" in these cases. But, if this counterfactual/but for approach to delineating relevant markets in monopolization cases is adopted, the duels will now be taking place in the right arena.

The Relevant Market for Merger Analyses That Involve "Unilateral Effects"

The Merger Guidelines' HMT+SSNIP paradigm was originally developed to delineate the relevant market in proposed mergers that involved homogeneous

(commodity) products and the concern that “coordinated effects” could arise from the merger. But the basic paradigm could encompass heterogeneous (differentiated) products as well.

The 1992 revision to the Merger Guidelines expanded the analysis of the potential consequences of mergers to encompass explicitly the possibility of “unilateral effects” that could follow from a merger of two firms that sell somewhat differentiated products. The 2010 “Horizontal Merger Guidelines” (HMGs) moved the analysis of the unilateral effects to a more central place in antitrust merger analysis. But the unilateral effects analysis in the 1992 revision and in the 2010 HMGs still starts with a formal process for delineating the relevant market: conducting the HMT so as to satisfy a SSNIP.

This formal process is unneeded for unilateral effects analyses – and risks muddying the analysis and confusing the decision-maker in such cases.

Let’s start with the analysis of the unilateral effects itself. Suppose that two firms that have proposed a merger sell differentiated products that are each the “runner-up” choices for an appreciable number of the purchasers of the other firm’s products. Prior to the merger, the prospect of losing those customers is part of the restraint on the ability of each firm to maintain higher prices. After the merger, those customers would be “recaptured” by the merged firm – and thus the merged firm would find it worthwhile to maintain higher prices. And let us suppose that this potential for post-merger unilateral effects has been ascertained through the collection and statistical analysis of empirical data (such as scanner data or consumer diaries or surveys).

In this case, the merged firm’s ability to effect a post-merger price increase – if that price increase satisfies the SSNIP criteria – means that the two firms’ overlapping products pass the HMT; *and thus the two firms’ overlapping products concomitantly constitute a relevant market*. In essence, for merger analysis purposes, this is a “2-to-1” merger or (equivalently) a “merger to monopoly” for this relevant market. That this result might not have quite the resonance of the outcome of, say the merger of Coke and Pepsi or of Verizon and AT&T is irrelevant; smaller markets are still relevant for antitrust. So long as the sales volume of one or both of the two overlapping products exceeds a “de minimis” level, the logic of this result stands.

There is no additional need to delineate the relevant market. The results of the data analysis – that the merged firm’s post-merger actions would satisfy the SSNIP criteria – have already delineated the relevant market. To engage in any further, separate efforts at delineating a relevant market – which, unfortunately, usually occurs in these cases – is, at best, irrelevant and a waste of time and effort and, at worst, risks confusing the decision-maker as to the correct analysis of the case.

Conclusion

The delineation of relevant markets in antitrust may not be especially “sexy”. It is unlikely to be in the headline of any antitrust policymaker’s testimony before Congress or the main topic in his/her speech before the American Bar Association.

But the delineation of relevant markets is central to sensible antitrust analyses of monopolization cases and proposed mergers. This essay points out the way forward to do better in both areas.

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This note draws on Lawrence J. White, “The Dead Hand of *Cellophane* and the Federal Google and Facebook Antitrust Cases: Market Delineation Will Be Crucial,” *Antitrust Bulletin*, March 2022; and Lawrence J. White, “Response to the DOJ-FTC ‘Request for Information on Merger Enforcement’: Clarifying Market Delineation in ‘Unilateral Effects’ Merger Cases,” April 21, 2022.

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