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COMMISSION AUTHORIZED
V87-5026

UNITED STATES INTERNATIONAL TRADE COMMISSION
WASHINGTON, D.C.
Before John J. Mathias
Administrative Law Judge

IN THE MATTER OF CERTAIN ELECTRICALLY RESISTIVE MONOCOMPONENT TONER AND "BLACK POWDER" PREPARATIONS THEREFORE	INVESTIGATION NO. 337-TA-253

PREHEARING STATEMENT OF
THE FEDERAL TRADE COMMISSION

INTRODUCTION

The Federal Trade Commission ("FTC") has sought and received permission from the International Trade Commission ("ITC") to participate in the proceedings before Your Honor.[1] Because certain issues in this proceeding appear to be much the same as those that arise in many cases under the antitrust laws,[2] our limited purpose herein is to offer our viewpoint, as an agency chartered to enforce the antitrust laws, on the proper analysis of those issues. We expressly take no position on the ultimate factual questions in this proceeding. Rather, our sole intent is to urge Your Honor to resolve these questions by employing the established legal and economic antitrust principles set forth below in considering the evidence to be presented in this case. These principles indicate that Canon must prove either that ERM toner for Canon

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[1] Request of the Federal Trade Commission to Intervene and Become a Party (December 22, 1986); ITC Action and Order (February 18, 1987).

[2] See infra note 4.

copiers is a meaningful line of "trade and commerce" or that Canon has market power within a larger copier market.

DISCUSSION

In its complaint under Section 337 of the Tariff Act of 1930, as amended, 19 U.S.C. § 1337, Aunyx charges that the respondent Canon has monopolized or attempted to monopolize[3] the "trade and commerce"[4] in electrically resistive monocomponent toner ("ERM toner") that is compatible with Canon's business line of copier machines.[5] Specifically, Aunyx accuses Canon of: (1) using leverage over its own dealers to prevent them from purchasing ERM toner from Aunyx, and to force them to buy such toner only from Canon; (2) interfering with

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[3] "The basic allegations of the complaint charge respondents with monopolization and attempted monopolization." ALJ Order No. 7: Initial Determination Designating the Investigation as More Complicated at 1 (November 19, 1986); ALJ Order No. 17: Initial Determination Granting Joint Motion to Designate the Investigation "More Complicated" and to Extend to Eighteen Months in Duration at 2 (April 9, 1987).

[4] In full, the operative part of Section 337, part (a), provides:

> Unfair methods of competition and unfair acts in the importation of articles into the United States, or in their sale by the owner, importer, consignee, or agent of either, the effect or tendency of which is to destroy or substantially injure an industry, efficiently and economically operated, in the United States, or to prevent the establishment of such an industry, or to restrain or monopolize trade and commerce in the United States, are declared unlawful, and when found by the Commission to exist shall be dealt with, in addition to any other provisions of law, as provided in this section.

19 U.S.C. § 1337 (emphasis added).

[5] Amended Verified Complaint at Para. 13 (July 29, 1986).

Aunyx's ability to obtain raw materials necessary for its production of ERM toner; (3) interfering with Aunyx's ability to market its ERM toner; and (4) using leverage over Aunyx in its capacity as a Canon copier dealer.[6] Additionally, Aunyx asserts that Canon conspired with certain of its dealers so that the dealers would not purchase ERM toner from Aunyx, but only Canon, and that such an agreement constitutes a conspiracy to monopolize Canon-compatible ERM toner and illegal exclusive dealing that substantially forecloses competition in ERM

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[6] To the extent that this conduct reflects non-price vertical restraints imposed by Canon on its dealers, the Supreme Court recognized in Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), that such restraints may serve a useful, procompetitive purpose and are to be analyzed under the rule of reason. For example, vertical restraints may promote marketing efforts by protecting dealer investments, id. at 55, and protect product quality and safety, id. at 55 n.23. Thus, if ERM toner compatible with Canon copiers is not easy to develop and formulate, then hypothetically one might expect Canon to discourage its dealers from selling possibly suspect non-Canon toner, in order to protect the quality of its copying systems. Even if Aunyx toner is presently of equal quality to that of Canon, Aunyx arguably may not have the same incentive as Canon to maintain the quality of its toner. Thus, Your Honor should examine whether there is a convincing efficiency explanation for Canon's vertical restraints. Of course, such restraints could be anticompetitive, e.g., if imposed to facilitate a horizontal agreement either at the manufacturer or the distributor level. In any event, any such anticompetitive effect must be assessed within the context of a relevant market. As we discuss below, however, ERM toner may or may not constitute such a relevant market.

toner.[7] Aunyx claims that these various charges describe "unfair methods of competition and unfair acts" subject to ITC jurisdiction under Section 337.[8]

Unlawful monopolization under Section 2 of the Sherman Act, 15 U.S.C. §2, requires proof of the following two elements: (1) the possession of monopoly power in a relevant market; and (2) the willful acquisition or maintenance of that power as distinguished from its growth or development as a consequence of a superior product, business acumen, or historic

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[7] As with monopolization and attempted monopolization charges, in an exclusive dealing claim it is critical to focus on the definition of the market in which the defendant is alleged to have market power. In a concurring opinion in Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2, 45 (1984), four Justices of the Supreme Court said:

> In determining whether an exclusive dealing contract is unreasonable, the proper focus is on the structure of the market for the products or services in question -- the number of sellers and buyers in the market, the volume of their business, and the ease with which buyers and sellers can redirect their purchases or sales to others....When the sellers of services are numerous and mobile, and the number of buyers is large, exclusive dealing arrangements of narrow scope pose no threat of adverse economic consequences. To the contrary, they may be substantially procompetitive by ensuring stable markets and encouraging long term, mutually advantageous business relationships.

As we suggest below, the market for assessing the anticompetitive effects of Canon's conduct may be the market for copier systems, rather than ERM toner. If so, an exclusive dealing arrangement in toner would be unlikely to cause the requisite competitive concern.

[8] See note 4, supra.

accident. United States v. Grinnell Corp., 384 U.S. 563 (1966). "Monopoly power" generally refers to the power to control prices or exclude competition. U.S. v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (1956). An unlawful attempt to monopolize under Section 2 of the Sherman Act requires proof of (1) specific intent to control prices or destroy competition, Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 626 (1953); (2) exclusionary or anticompetitive conduct, id.; and (3) a dangerous probability of success. Swift & Co. v. United States, 196 U.S. 375, 396 (1905).[9]

In essence, then, a monopolization (or attempted monopolization) case must focus on whether the defendant possesses (or has a "dangerous probability" of obtaining) the ability to raise and maintain prices above the competitive level. Absent that ability, there can be no harm to consumers (and, indeed, the "monopoly" would appear to have little to offer the purported monopolist). Reflecting this, the Department of Justice Merger Guidelines ("DOJ Guidelines") refer to "market power" as the ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time.[10]

There is a threshold issue that must be resolved before any assessment of actual or potential market power can be made:

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[9] See also, International Telephone & Telegraph Corp., 104 F.T.C. 280, 400 (1984).

[10] DOJ Guidelines, 49 Fed. Reg. 26,827 (1984).

what is the relevant market in which to test the defendant's power over price? "Without a definition of [the relevant] market there is no way to measure [a defendant's] ability to lessen or destroy competition." Walker Process Equip., Inc., v. Food Mach. & Chem. Corp., 382 U.S. 172, 177 (1965).

Again, the definition of a relevant market turns on the ability of incumbent firms successfully to impose anticompetitive prices. The DOJ Guidelines provide a comprehensive framework for determining a relevant market, which they define as:

> a product or group of products and a geographic area in which it is sold such that a hypothetical, profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products in that area could impose a "small but significant and nontransitory" increase in price above prevailing or likely future levels. [11]

To determine whether such a price increase would be profitable, the Guidelines recommend an analysis of four types of supply and demand responses to a hypothetical "small but significant and non-transitory price increase." These include (1) consumers switching to other products; (2) consumers switching to the same product produced by other firms in other areas; (3) producers switching existing production facilities to produce the product; and (4) producers substantially

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[11] DOJ Guidelines, 49 Fed Reg. 26,827 (1984).

modifying existing facilities or constructing new facilities to enter into production of the product.[12]

Thus, in our view, the critical question to be asked and answered throughout the course of this hearing is, "Could Canon profitably raise the price of ERM toner above the competitive level for a substantial period of time?" More specifically, because ERM toner is used as one component of a larger copier system, Your Honor should determine whether an effort by Canon to exercise market power over ERM toner used in Canon machines would in fact be profitable. It may be that Canon system users could simply turn to competing copier systems if the costs of Canon supplies, and therefore Canon systems, became noncompetitive.

In this regard, it will be important to examine evidence concerning the various factors that affect the cost of photocopy production and the relative significance of the price of toner.[13] Even if users of Canon copiers may not have the immediate ability to substitute toners supplied by other producers, and the short run price elasticity of demand for Canon toner is therefore small, the evidence could show that Canon toners may still compete with other toners in the larger arena of copier systems. Further, to the extent that copiers

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[12] Id. at 26,827-28.

[13] The ITC noted Canon's claim that the cost of toner represented 15-20% of the total cost of a copier system over its lifetime. Certain Copier Toner From Japan, Inv. No. 731-TA-373 (Preliminary) USITC Pub. 1960 at 7 (1987).

are obtained pursuant to lease agreements, rather than by purchase, customers might have relatively little investment in their copier systems and have little difficulty in switching to other machines.[14]

Receiving and evaluating this type of evidence in this proceeding appears to be especially important in view of the interest shown in the subject by all of the ITC Commissioners in a recent, related proceeding, Certain Copier Toner From Japan, Inv. No. 731-TA-373 (Preliminary) USITC Pub. 1960 (1987) ("Certain Copier Toner"). In that antidumping proceeding, the Commission was called upon to define the "like product" affected by imports.[15] Although the majority of the Commissioners accepted ERM toner as a "like product" for purposes of the preliminary antidumping investigation, they did so with reservations, "for the purposes of further analysis." The majority suggested that it might have defined the product differently in a final investigation. Certain Copier Toner at 8. Commissioner Rohr also observed that "the more compelling argument from the standpoint of the logic of the marketplace,

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[14] Id.

[15] To find an antidumping violation, the ITC must determine the "industry" affected by the alleged offending imports. The statute defines "industry" as the domestic producers of a "like product." 19 U.S.C. §1677(4)(A). In turn, "like product" is defined as a product alike or similar in characteristics and uses to the product subject to investigation. 19 U.S.C. 1677(10).

rests on the broader definition . . . ." Certain Copier Toner at 20.[16]

Chairman Liebeler and Vice Chairman Brunsdale went further, writing separately to express their view that:

> [T]he record is clear that customers buy copying systems, not toner, and that per-copy cost plays a central role in their selection of a copying system. One of the principal elements of per-copy cost is the ongoing cost of toner. If the price of toner available for a system is too high, the entire system is uncompetitive with other systems. In such a circumstance, customers, other things being equal, will switch to a different copy system to gain the per-copy savings resulting from the lower priced toner. In short, from the customers' perspective, various types of toner are realistic substitutes because the different types of copiers are realistic substitutes. Customers freely choose between different types of toner because they can easily switch to a different type of copier.[17]

Thus, it would appear that some, if not all, of the ITC Commissioners would find useful Your Honor's assessment of the evidence based on the analytical approach we suggest in this brief.

The Ninth Circuit recently applied this sort of analysis in General Business Systems v. North American Philips Corp., 699 F.2d 965 (9th Cir. 1983), a case that appears to be very similar to the pending matter. There, General Business Systems ("GBS"), a Philips distributor, charged Philips, a manufacturer

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[16] This treatment of the "like product" definition did not affect the decision because the ITC still determined that there was insufficient market injury to warrant relief under the antidumping statute. Certain Copier Toner at 1.

[17] Certain Copier Toner at 28.

of small business computers, with monopolization and attempted monopolization of magnetic ledger cards ("mlcs").[18]

The key issue was whether mlcs for Philips computers constituted a relevant market for analyzing the monopolization and attempted monopolization claims brought by GBS against Philips. The district court rejected this market definition and the Ninth Circuit agreed.

> [T]he market for Philips-compatible mlcs was not insulated from the competitive struggle between computer systems . . . . Philips had little or no power to raise the price of its mlcs without reducing its profits because any such increase would diminish sales of its computer system and very likely adversely affect aggregate profits. Were mlc prices significantly increased, computer system buyers quickly could shift to other sellers who, in turn, could profitably expand their output to meet the new demand . . . . [T]he market for mlcs cannot be separated from the general market for small business computer systems.

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[18] Philips computers stored memory on mlcs that were compatible only with its own computers. Indeed, Philips did not attempt to sell its mlcs for use in any other computer. The mlcs were an essential component of the computer system; the quality of the mlcs materially affected the system's overall operating performance; and the cost of the replacement mlcs was a substantial part of the total operating cost of the computer system.

The mlcs were produced for Philips, per Philips' specifications, by two German companies. GBS successfully sought to purchase the mlcs directly from one of the German companies and to compete with Philips in the sale of replacement mlcs for the Philips computers. Philips, in response, renegotiated its contract with the German company supplying the mlcs to GBS, and the German company then ceased selling mlcs to GBS.

General Business Systems v. North American Philips Corp., 699 F.2d at 972 (emphasis in the original).[19]

Thus, just as small business computer systems, rather than mlcs, comprised the relevant market in General Business Systems, it may be that the monopolization and attempted monopolization charges in this matter, depending on the facts, should be evaluated in the context of a copier systems market, rather than a market for ERM toner or Canon-compatible ERM

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[19] See also MLC, Inc. v. North American Philips Corp., 1983-1 Trade Cas. (CCH) Para. 65,351 (S.D.N.Y. 1983). This was a parallel case to the one in California that was brought by a different plaintiff, MLC, Inc., a company that sought to import and distribute the mlcs used in the Philips computers. Here, too, claims were advanced that Philips monopolized the market for mlcs used in its own computers. The district court extensively cited and agreed with the Ninth Circuit's opinion, and dismissed the monopolization claims.

Another case that specifically followed the Ninth Circuit's analysis in General Business Systems was Slocomb Industries, Inc. v. Chelsea Industries, Inc., 1984-1 Trade Cas. (CCH) Para. 65,932 (E.D. Pa. 1984), where the principal issue was the definition of the relevant product market. The plaintiff alleged that the defendant monopolized the market for extruded vinyl profiles sold to fabricators of vinyl windows. Window profiles were manufactured for different window designs and could not, like ERM toner, readily be substituted for each other.

> These facts lead to the inescapable conclusion that the proper market is not extruded vinyl profiles. The real competition is plainly not at the component level, because the components are fundamentally different. Any competition between Slocomb and Poly-Tex would clearly be at the final product level -- the market for vinyl windows.

Slocomb Industries,Inc. v. Chelsea Industries, Inc., 1984-1 Trade Cas. (CCH) at 68,028.

toner. Whether Canon has the requisite market power in copiers to warrant further antitrust concern by Your Honor or the ITC is open to question.

CONCLUSION

Sound economic analysis and antitrust principles suggest that Your Honor should require Aunyx to demonstrate either that ERM toner for Canon copiers is a meaningful line of "trade and commerce" subject to monopolization or that Canon has sustantial market power within a larger copier market.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Steven A. Rothman, an attorney with the Federal Trade Commission, hereby certify that the original and fourteen copies of the foregoing Prehearing Statement of The Federal Trade Commission have been filed with the Secretary of the International Trade Commission, and service has been made on the following parties, this 20th day of August, 1987, in the manner indicated:

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