FTC v. Amazon: Market Definitions and Section 5 of the FTC Act

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Abstract: The Federal Trade Commission's (FTC) challenge to Amazon.com's practices relating to its participation on its own platform—competing with the many merchants who rely on the powerful commercial hub to make sales—violate the Federal Trade Commission Act. The court's analysis is likely to depend heavily on the FTC's definition of the relevant antitrust markets in which it claims Amazon possesses market power and harms competition. Traditional antitrust economics face significant challenges grappling with the relatively new digital economy. The author examines these and other issues raised in the case, which he anticipates will be a crucial test for antitrust and the FTC Act.

Introduction

The Federal Trade Commission (FTC) and 17 state attorneys general on September 26, 2023, filed their long-awaited antitrust complaint against Amazon.com in federal district court in the Western District of Washington. The complaint is a foreseeable ambition of FTC Chair Lena M. Khan, who as a Yale law school student authored an influential law review article titled "Amazon's Antitrust Paradox."[1] The article itemized conduct Khan characterized as "anticompetitive," which, when committed by a dominant firm with market power, can be unlawful under the antitrust laws.

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Establishing Amazon's Conduct as Anticompetitive

Establishing in court whether Amazon's conduct is "anticompetitive," or that Amazon possesses market power, can pose challenges, particularly in a "new economy" industry such as Amazon's digital marketplaces for goods and marketing services. The court's analysis is likely to depend heavily on the FTC's definition of the relevant antitrust markets in which it claims Amazon possesses market power and harms competition.

The complaint defines two relevant markets, the "online superstore market" and the "online marketplace services market." The FTC alleges that Amazon is a monopolist in both markets and engages in anticompetitive conduct to maintain its two monopolies (Counts I, II, V, and VI). Although all the counts allege violations of Section 2 of the Sherman Act, which prohibits monopolization, the first two are drafted principally as violations of Section 5(a) of the FTC Act, which makes unlawful all "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce."

The complaint alleges that "a core strategy" pursued by Amazon to maintain its monopolies is to punish sellers on its platforms that offer lower prices anywhere other than on Amazon. As a result of these "anti-discounting" policies, the complaint alleges, Amazon can deprive rival online superstores of sufficient scale and scope to challenge Amazon. Amazon, of course, will argue that its policies are not anticompetitive at all, but merely requirements meant to ensure that Amazon customers are offered the lowest available price.

Faced with these contrasting viewpoints, the court is likely to conduct a detailed antitrust analysis, starting with the alleged relevant markets. The market described in the complaint as "online superstores" seems to describe a particular kind of multiline retail distributor. This is an economically coherent relevant market as long as it makes sense to consider the cross price-elasticity of demand as between two or more candidates for inclusion in such a market. The (theoretical) cross elasticity variable comes into play in the hypothetical monopolist test. If a hypothetical monopolist in a

candidate market can profit from a non-transitory price increase of, say, 5 percent, the candidate market is a relevant antitrust market. But if a price increase causes enough buyers to switch to some other product or service, that product or service belongs in the relevant market and the candidate market definition must be enlarged.

Here, the FTC and the states seem to focus on competition between multiline online retailing websites. The key issue is whether a price increase on Amazon could drive online shoppers to Google Shopping, Walmart, Target, Costco, eBay, Home Depot, Best Buy, Wayfair, or any number of other online retail destinations that are potential substitute outlets for products sold on Amazon.

Supporting Precedent

To be sure, there is ample precedent for defining a particular type of distribution channel as a relevant market. For example, in *FTC v. Sysco Corp. and US Foods*,[2] the court accepted a market defined as "broadline foodservice distribution services." In that case, the court found that hotels and restaurants were confronted with only a limited choice of distributors who could offer their customers centralized ordering of a wide variety of foods and supplies that such institutions regularly purchase. It is reasonable to test whether customers of broadline distributors would have anywhere else to go if a hypothetical monopolist imposed a non-transitory price increase. Similar reasoning applied in the "office superstore" mergers, in which the relevant market is comprised of multi-line office supply stores that cater to large organizations that regularly purchase a broad line of office supplies.

In *Bon-Ton Stores v. May Dep't Stores Co.*,[3] the court enjoined a merger between May Department Stores and McCurdy & Co., another department store chain, after considering whether the relevant market was "traditional department stores" or the much broader, "general merchandise, apparel and furniture" market advocated by the merging parties. The court concluded that "traditional department stores provide a distinct, identifiable, 'product' that distinguishes department stores from other retailers."

In the Amazon case, the court is going to want to know the economics behind the alleged "online superstore" market definition,

so it is likely to examine whether the definition makes economic sense when it comes to retail sales to the general public. For large offices and institutions with recurring supply orders, it is clear why the choice of supplier can depend on whether the seller is a broadline distributor that offers one-stop shopping. It is far less clear that consumers care whether Amazon is a "superstore." If the significance of Amazon's scope is solely to increase the likelihood that Amazon will be able to sell to a particular consumer, then being a "superstore" means little more than Amazon is likely to carry the sought-after product and Amazon being a superstore offers no additional efficiency to the consumer beyond any other online seller of the product. Since the fact of being a superstore may be of little or no importance to an individual consumer for a given transaction, the court may look skeptically on the superstore market definition and conclude that narrow-line online retailers also belong in the relevant market because the cross elasticities that matter occur on a product-by-product basis.

To make the point another way, starting with Amazon as the only firm in an initial candidate market, how will the FTC establish whether or not few enough customers would purchase elsewhere in the event of an (across-the-board) non-transitory price increase so that such an increase would be profitable for Amazon? Surely, an impossible task on the individual product level and average or aggregated prices may be a poor proxy for the "price" of using one online superstore as opposed to another, which is the market in which Amazon is alleged to be unlawfully maintaining its monopoly.

The FTC's choice of a "superstore" market definition is especially surprising in light of several cases currently pending in the Western District of Washington in which Sherman Act violations are alleged based on the same "anti-discounting" and "fulfillment bundling" conduct as in the FTC complaint. In *Frame-Wilson v. Amazon.Com, Inc.*,[4] *De Coster v. Amazon.Com, Inc.*,[5] and *Brown v. Amazon.Com. Inc.*,[6] purchasers from on Amazon's third-party marketplace sellers that also sell on non-Amazon websites brought suit alleging harm in the broader "online retail" market. Additionally, these complaints identify numerous online "sub-markets" in which Amazon enjoys an outsized market share compared to other online

outlets, that is, home improvement tools (93 percent), men's athletic shoes (74 percent), skin care (91 percent), batteries (97 percent), golf equipment (92 percent), cleaning supplies (88 percent), and kitchen and dining wares (94 percent).

In a similar vein, the state court sustained claims for state Cartwright Act and Unfair Competition Law violations in the market of "online retail sales of new products for custom delivery (e.g., delivery to the customer's home) . . ." in *People of the State of California v. Amazon.com, Inc.*[7] Like the court in *Frame-Wilson* and its progeny, the court found the existence of a separate antitrust market for online sales (as opposed to brick-and-mortar retail stores) to be a plausible market definition, or at least not facially unsustainable.

Identifying a separate market for online sales comports with the logic of *Sysco* and *Bon-Ton Stores* because the distinction between online and brick-and-mortar sales is likely to be strongly correlated with the degree to which consumers do or do not consider two competing retailers to be interchangeable. It is plausible that for many product categories the general public do not consider online and physical retailers to be substitutable enough to belong in the same antitrust market. It is far more dubious to claim that consumers do not consider two online retailers to be substitutable because one is a specialty or narrow-line retailer and the other is a "superstore."

In *Frame-Wilson*, the court found that the complaint alleged "sufficient facts to support a distinction between the ecommerce retail market and the physical retail market, even though the same products may be available in both." It would not appear, by contrast, that the FTC and the participating states have alleged sufficient facts to support a distinction between an online superstore and any other online store.

Even in the four of pending cases in which the relevant market was online retailing (with product category submarkets), the courts were all careful to emphasize that the definition of the relevant market was a matter for the trier of fact and not a determination that can be made on a motion to dismiss. In *De Coster*, the court found Amazon's arguments against the plaintiffs' market definition to be "fact-based and premature, essentially asking the Court to hear expert testimony at the motion-to-dismiss stage of litigation."

Section 5 of the FTC Act

Even if the FTC's alleged market definition fails, Amazon's policies of prohibiting price discounting on non-Amazon sites is likely to be harmful to competition and to raise prices to consumers. The challenge for the FTC and other enforcers is to construct a case that reaches Amazon's conduct but remains within the parameters of accepted antitrust principles. In what is perhaps an acknowledgment that the Amazon case does not fit neatly within a traditional Sherman Act framework, the Commission's complaint alleges monopoly maintenance of its two relevant markets twice, once as violations of Section 5 of the FTC Act and again as violations of Section 2 of the Sherman Act.

Section 5 of the FTC Act offers a path for the court to condemn the conduct without necessarily finding that Amazon is engaged in maintaining a monopoly or has violated Section 2 of the Sherman Act. Of course, this depends on whether the court believes that Section 5 establishes a violation for conduct that does not itself violate Section 2 or any of the other antitrust laws. Thus, the Amazon case may be a crucial test of the usefulness of Section 5 to reach anticompetitive conduct in circumstances in which monopolization cannot be proven by a preponderance of the evidence.

The second market definition in the complaint, for "online marketplace services," attempts to support the claim that by rewarding sellers that use Amazon fulfillment services and punishing those that do not, Amazon harms competition among providers of online marketing services. Even with the fallback of Section 5, this claim is likely to face substantial challenges. While the claim superficially resembles a tying claim, in which a monopolist in one market forces its customers to purchase a product in a different market, there would appear to be little to distinguish Amazon's conduct from everyday "bundling" of related goods or services. To plead a tying claim, the complaint must define *two* markets, one that is monopolized by the defendant and another that is competitive but harmed by the monopolist's tying conduct. Having alleged only a single market, however, the complaint confines itself to the theory that Amazon's bundling of fulfillment services has the effect of maintaining its monopoly in the marketplace services market,

not that it harms competition between providers of fulfillment services. Here, it is unlikely that even Section 5 will save the day for the agency and the states.

Conclusion

Traditional antitrust economics faces significant challenges grappling with the new economy industrial environment, and the Amazon case is likely to be a crucial test for antitrust and the usefulness of Section 5 of the FTC Act.

Notes

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1. Lina M. Khan, "Amazon's Antitrust Paradox," Yale Law Journal, 126:710, 2017.
2. 113 F. Supp. 3d 1 (D.D.C. 2015),
3. 881 F. Supp. 860 (W.D.N.Y. 1994).
4. 591 F. Supp. 3d 975 (W.D.Wa. 2022).
5. 2023 U.S. Dist. LEXIS 12365, 2023 WL 372377 (W.D. Wa.).
6. 2023 U.S. Dist. LEXIS 158801, 2023 WL 5793303 (W.D. Wa.).
7. Case No. CGC-ss-601826, Cal. Sup. Ct., filed May 25, 2021.