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THE DEPARTMENT OF JUSTICE'S REPORT ON SINGLE-FIRM CONDUCT UNDER THE SHERMAN ACT

New Policy Guidance That Would Significantly Weaken Antitrust Enforcement

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On September 8, 2008, the Antitrust Division of the U.S. Department of Justice ("DOJ") issued its long awaited Report on single-firm conduct under the Sherman Act. The 215-page Report followed a year-long series of hearings jointly held by the DOJ and the Federal Trade Commission ("FTC"). The final product, which drew heavy criticism from the FTC, announces new proposed standards for unilateral conduct that would make it more difficult and costly for businesses (and consumers) to bring antitrust lawsuits and add greater uncertainty to the assertion of antitrust claims.

The Report primarily addresses the following aspects of Section 2 claims: monopoly power, exclusionary conduct, predatory pricing, tying, bundled discounts and single-product loyalty discounts, refusals to deal and exclusive dealing.

MONOPOLY POWER

The Supreme Court has defined monopoly power as the ability to raise prices or exclude competition.¹ An often described essential component of monopoly power is "dominant market share," or "market power," which may be inferred when a company controls a high percentage of the relevant market. The courts have not articulated a precise market share from which monopoly power must be inferred. The Supreme Court has also explained that market share is not the only way to demonstrate monopoly power because when there is "proof of actual detrimental effects, such as reduction of output," market power is but a "surrogate for detrimental effects."² This well-accepted dualistic standard has been employed by courts around the country.³

The DOJ Report does what no court has ever previously thought appropriate—it articulates an exact threshold market share requirement for monopolization claims. Specifically, the DOJ advises that, to find a rebuttable presumption of monopoly power, a firm must have a market share in excess of two-thirds for a significant period and market conditions must be such that this market share will not be threatened in the near future. Moreover, the DOJ recommends that courts do away with the dualistic approach to inferring monopoly power and proposes a safe-harbor for companies with less than the threshold two-thirds market share. Indeed, the DOJ contends that it is unaware of a single case in which a firm was held to have monopoly power with less than a fifty percent market share. This rationale is troubling because it ignores decisions wherein courts have found market power when companies control between 50-66 percent of the relevant market. This approach would also legalize conduct when the market share threshold has not been met even if a plaintiff has demonstrated, through direct evidence instead of indirect evidence of market share, that a company has monopoly power. As the DOJ itself concedes, its approach may also effectively immunize anticompetitive conduct if the court adopts the wrong market definition. Thus, in an attempt to create a hard and fast rule for monopolization cases, the DOJ's proposal would immunize potentially anticompetitive conduct where monopoly power was demonstrated by direct evidence.

¹ *United States v. Grinnell Corp.*, 384 U.S. 563 (1966).

² *F.T.C. v. Indiana Federation of Dentists*, 476 U.S. 447, 460-61 (1986).

³ See, e.g., *Toys "R" Us, Inc. v. F.T.C.*, 221 F.3d 928, 937 (7th Cir. 2000).

■ EXCLUSIONARY CONDUCT

Courts have long struggled with the allocation of the burdens of proof and production in Section 2 exclusionary conduct cases. Consequently, there is no clear standard that governs such Section 2 claims nor is there a consensus as to whether one standard is even appropriate. As the courts wrestle with these issues, the following tests have emerged in Section 2 cases: the effects-balancing test; the profit-sacrifice test; the no-economic sense test; the equally-efficient competitor test; and the disproportionality test.

The DOJ recommends the retirement of both the effects-balancing test and the profit-sacrifice test for Section 2 liability. The effects-balancing test focuses on the alleged anticompetitive conduct's "overall impact on consumers" while the profit-sacrifice test asks whether the firm sacrificed short-term profits in an effort to drive rivals out of the market. The DOJ concludes that neither test can predictably be used by businesses to determine whether their proposed conduct may violate Section 2.

The Report strongly advocates the application of a "disproportionality test," which has never been used by the courts, to a wide range of Section 2 offenses.

The DOJ was somewhat more receptive to the no-economic sense test and the equally-efficient competitor test. The no-economic sense test is a close cousin to the profit-sacrifice test- it compares the firm's non-exclusionary profits to the profits the firm would have earned from alternative, legal conduct in the so called "but for" world. While acknowledging this test's many weaknesses, including its tendency to immunize

conduct likely to harm competition (*i.e.*, "a false negative"), the DOJ recommends its use in certain exclusionary conduct cases without much elaboration.

The equally-efficient competitor test asks whether the "challenged practice is likely in the circumstances to exclude from defendant's market an equally or more efficient competitor."⁴ Though this test has been criticized because it is both difficult to administer and could lead to false negatives, the DOJ recommends its use in predatory pricing cases.

The Report strongly advocates the adoption of a "disproportionality test," which has never been used by the courts. Under this test, when a firm's conduct has potentially both anticompetitive and procompetitive effects, a Section 2 violation will be found when the anticompetitive harm *disproportionately* outweighs any procompetitive benefits. As the DOJ itself concedes, this test places a greater burden on plaintiffs in Section 2 cases. Moreover, in addition to weeding out previously valid Section 2 claims premised on anticompetitive conduct that merely outweighed any procompetitive effects, this test would also add a new layer of uncertainty for businesses who will be left struggling to determine what balance of effects is sufficiently "disproportionate" for a finding of liability. The Report recommends the application of this test to a wide range of Section 2 offenses that are normally analyzed under a substantially more relaxed standard of liability.

■ PRICE PREDATION

Predatory pricing is generally considered the practice of selling a product at an unduly low price in order to drive competitors out of the market. According to the Supreme Court's seminal decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 212 (1993), a predatory pricing claim is premised on a showing that (1) prices were "below an appropriate measure" of defendant's short term costs; and (2) defendant had a "dangerous probability of recouping its investment

⁴ DOJ Report, at 43 (citing RICHARD A. POSNER, ANTITRUST LAW 194-95 (2d ed. 2001)).

in below-cost prices.”⁵ A lingering issue for the lower courts is the proper measure by which to analyze defendant’s short term costs. However, a common approach employed by many lower courts is the “average variable cost test,” which is the sum of all costs that vary when there is a change in the quantity of output, divided by the quantity of actual goods produced.

Despite the general acceptance of the average variable cost test, the Report recommends adoption of the virtually untested “average avoidable cost” test, *i.e.*, the sum of both fixed and variable short term costs, as the appropriate cost measure in predatory pricing cases. The DOJ’s primary support for this approach is that the average avoidable cost test eliminates the need for courts to delve into the difficult task of differentiating fixed costs from variable costs. The Report also recommends, without reliance on any Supreme Court authority, that it should be presumed *per se* legal for a firm to charge prices that are above its average avoidable cost.

■ TYING

A tying arrangement is the conditioning of the sale of one product (the “tying” product) on the purchase of another product (the “tied” product). A challenged tying arrangement is generally analyzed under a standard of presumptive illegality referred to as the *per se* rule, which has long been accepted in tying cases. Indeed, almost a quarter century ago, the Supreme Court announced that “it is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose an unacceptable risk of stifling competition and therefore are unreasonable *per se*.”⁶ Nevertheless, the Report seeks to undo that history by recommending that courts no longer apply the *per se* standard to tying claims, even to firms with monopoly or near monopoly power, because the historically illegal practice can benefit consumers and competition in certain circumstances. Thus, the DOJ would impose a much greater burden on plaintiffs in tying cases by requiring a showing that a tying arrangement has anticompetitive effects and that these effects disproportionately outweigh any procompetitive justification for the tying practice.

■ BUNDLED DISCOUNTS AND SINGLE-PRODUCT LOYALTY DISCOUNTS

When a company conditions a discount on one product on the purchase of a separate product, the company is considered to be offering a “bundled discount.” Over thirty years ago, in *SmithKline Corp. v. Eli Lilly & Co.*,⁷ the Third Circuit first held that a bundled discount could violate Section 2 when the defendant possesses monopoly power over some (but not all) of the bundled products. In recent years, there has been a growing trend in the lower courts that a bundled discount will not be held to violate Section 2 unless it results in below-cost sales.

The Report recommends new standards that would significantly weaken, if not eliminate, bundled discount claims. First, the Report suggests a safe harbor akin to its recommendation for predatory pricing claims where bundle-to-bundle competition is reasonably possible. Second, if bundle-to-bundle competition is not reasonably possible, the Report recommends an additional safe harbor when the product subject to competition was sold at an imputed price above the defendant’s incremental cost for that product. Should a firm’s conduct fall outside either of these safe harbors, the Report proposes that plaintiff be required to demonstrate either that the bundled discount has no procompetitive justification or, if it does, that the harmful effects of the discount are *substantially disproportionate* to any procompetitive benefit.

The Report recommends a similar safe harbor for single-product loyalty discounts in most cases. A single-product loyalty discount is the practice of offering a discount or rebate conditioned on the level of purchases made by the customer. The Report treats loyalty discounts as predatory pricing claims, and would allow a safe harbor when the price of the product is above the company’s average avoidable cost.

⁵ *Id.* at 224.

⁶ *Id.* at 9.

⁷ 575 F.2d 1056 (3d Cir. 1978)

■ UNILATERAL REFUSALS TO DEAL

While courts generally do not require competitors to do business together, the legality of a refusal to deal with a rival is not absolute, and can give rise to liability under certain limited circumstances. The seminal case in this area is *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*⁸ In *Aspen Skiing*, the defendant owned three out of the four ski mountains, but had entered into a business relationship with plaintiff, the owner of the fourth ski mountain. Defendant ultimately terminated this relationship and refused to provide plaintiff with any access to its ski mountains, even though plaintiff offered to purchase tickets at retail prices. The case culminated in an upheld jury verdict in favor of the plaintiff.

The Report recommends that claims for unilateral refusal to deal with competitors no longer play a meaningful role in antitrust enforcement. Interestingly, the Supreme Court has never issued such a broad-brush attack on this antitrust jurisprudence. Indeed, it had occasion to revisit such refusal to deal claims as recently as 2004 in *Verizon Communications Inc. v. Trinko*,⁹ and reaffirmed the continued viability of refusal to deal liability in certain cases. Thus, it appears that the DOJ is willing to slam shut the door left open by the Supreme Court in *Trinko*.

■ EXCLUSIVE DEALING

Exclusive dealing under Section 2 generally refers to a number of situations in which vertical market participants agree to deal with one another on an exclusive basis. For example, liability can be premised on a manufacturer's exclusive access to a downstream distributor that forecloses distribution among its rivals. While recognizing that exclusive dealing arrangements can harm consumers, especially when rivals are driven from the market, the Report focuses on the potential procompetitive benefits of exclusive deals and concludes that yet another safe harbor is warranted. The Report recommends that exclusive

arrangements that foreclose less than 30 percent of existing customers or effective distribution should not be considered illegal. Moreover, when the safe harbor does not apply, the Report recommends that courts apply the disproportionality test for liability. Consequently, the Report's proposed arbitrary safe harbor coupled with a more rigorous burden of proof would, if accepted by the courts, make it significantly more difficult to bring successful claims for exclusive dealing.

■ CONCLUSION

Though not binding on the next administration, the DOJ's Report, if adopted, would mark a watershed moment in the history of antitrust jurisprudence. The Report's recommendations, at a minimum, signify the DOJ's willingness to elevate the interests of large corporations over those of smaller, less powerful businesses and consumers ostensibly in an attempt to provide bright-line tests in Section 2 cases. This salutary goal, however, is undermined by one-sided recommendations which tend to give large corporations a free pass for arguably anticompetitive conduct. If implemented, many of the DOJ's recommendations could also lead to greater uncertainty in antitrust litigation, as courts struggle to give meaning to concepts such as "disproportionate" and attempt to flesh out the contours of the average avoidable cost test. Unfortunately, the virtual immunization of previously unlawful anticompetitive conduct appears to be a price the DOJ is willing to pay in order to provide businesses with what it believes are more definite standards for potential antitrust liability.

⁸ 472 U.S. 585 (1985).

⁹ 540 U.S. 398 (2004).

It is not intended or suggested that the information contained in this publication be applied in any particular case or situation without a detailed professional review of the facts of that case or situation.