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DOJ Report on Section 2 of the Sherman Act: Skirmish or Schism?

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I. INTRODUCTION

Beginning in 2006, the two U.S. antitrust agencies, the United States Department of Justice, Antitrust Division ("DOJ") and the Federal Trade Commission ("FTC") together co-sponsored more than two years of joint public hearings on the treatment of unilateral conduct under the U.S. antitrust laws, including 29 individual panels and 119 witnesses at various hearings around the country. On September 8, 2008, the DOJ issued a new 215-page report—*Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act* ("Report")—summarizing the DOJ's views and guidance on unilateral conduct based in part on the joint public hearings as well as "extensive scholarly commentary, and in the jurisprudence of the Supreme Court and lower courts."[1] The FTC on the other hand, refused to endorse the Report, and publicly voiced its differences in a joint statement by three FTC Commissioners. The DOJ and FTC have skirmished several times over the last several years regarding divergent policy views. This latest dispute may just be another skirmish in a continuing healthy debate, but also could be a sign of a more serious schism that leads to stagnation, less discourse, and more

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[1] U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT vii (2008) ["REPORT"], http://www.usdoj.gov/atr/public/reports/236681.pdf. http://www.usdoj.gov/atr/public/reports/236681.pdf.

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confusion over U.S. antitrust enforcement policies.

What is clear from this latest public airing of differences is that the DOJ and the FTC appear to have very distinct views on enforcement policies regarding monopolization and single firm conduct under Section 2 of the Sherman Act. While recognizing the FTC's contributions on the area, the DOJ "remains solely responsible for the contents of this report."[2] Thus, it represents only the DOJ's "enforcement policy and is intended to make progress toward the goal of sound, clear, objective, effective, and administrable standards for analyzing single-firm conduct under section 2 [of the Sherman Act]."[3]

Not only did the FTC refuse to endorse the Report, but sharply criticized it. The FTC had two "overarching concerns" with the Report. First, "the Department's Report is chiefly concerned with firms that enjoy monopoly or near-monopoly power, and prescribes a legal regime that places these firms' interests ahead of the interests of consumers," and second, "the report seriously overstates the level of legal, economic, and academic consensus regarding Section 2."[4] The three FTC Commissioners claimed that the Report, "if adopted by the courts, will be a blueprint for radically weakened enforcement of Section 2."[5]

The only sitting Commissioner who did not sign onto the bipartisan FTC statement was the Chairman, William E. Kovacic. In a separate statement, Chairman

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[2] REPORT at 3.

[3] REPORT at vii.

[4] Statement of Commissioners Harbour, Leibowitz, and Rosch on the Issuance of the Section 2 Report by the Department of Justice (Sept. 8, 2008).

[5] *Id.*

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Kovacic regretted that both agencies could not prepare a document that reflected their common views on enforcement, but then took a much more diplomatic view of the DOJ's Report. He noted that the Report lacked historical perspective, adding that "[h]istorical context can supply an extremely helpful foundation for a review of current doctrine and a statement of suggested enforcement approaches."[6] Chairman Kovacic continued with a brief overview of the historical context of Section 2 enforcement and how it helped to shape current law and policy.

The next logical step in placing the DOJ's Report and the FTC's divergent views on dominant firm conduct into context is to consider the upcoming presidential elections in the United States. A new executive will bring his own enforcement priorities. Generally, it is safe to assume that a Republican victory will lead a move in the direction of the DOJ's view on policy and enforcement along the lines of the DOJ Report. Conversely, a Democratic victory will likely mean a move toward the FTC's current view of Section 2 enforcement.

6 Statement of Federal Trade Commission Chairman William E. Kovacic, Modern US Competition Law and the Treatment of Dominant Firms: Comments on the Department of Justice and Federal Trade Commission Proceedings Relating to Section 2 of the Sherman Act (Sept. 8, 2008)

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II. HIGHLIGHTS OF THE REPORT

The Report touches on a broad range of legal issues and priorities for Section 2 enforcement of unilateral conduct.

A. Market Power and Market Share Measurements

The Report underscores the importance of market power and monopoly power when evaluating single firm conduct. The Report notes that the DOJ will presume monopoly power when a "firm has maintained a market share in excess of two-thirds for a significant period and the firm's market share is unlikely to be eroded in the near future."[7] The DOJ also noted that "no court . . . has found monopoly power when defendant's share was less than fifty percent."[8]

B. New "Disproportionality Test" to Evaluate and Identify Wrongful Unilateral Conduct

One of the more notable conclusions from the Report is the DOJ's proposal of a new general standard to identify illegal conduct by a monopolist. In doing so, the DOJ rejected three other general standards previously recognized by courts and commentators in assessing whether or not challenged conduct is anticompetitive: (i) the effects-balancing test; (ii) the profit-sacrifice and no-economic-sense test; and (iii) the equally efficient competitor test.

Referring to the DOJ and the FTC's joint brief as Amici Curiae in the *Trinko*

[7] REPORT at 30.

[8] *Id*. at 24.

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case,[9] the DOJ recommends a new general disproportionality test. Under this test, the DOJ proposes that unilateral conduct is anticompetitive if "its likely anticompetitive harms substantially outweigh its likely pro-competitive benefits."[10] The DOJ acknowledges, however, that "different types of conduct warrant different tests, . . . [but when] a conduct-specific test is not utilized, the disproportionality test is likely the most appropriate test identified to date for evaluating conduct under section 2."[11]

C. Predatory Pricing

The Report notes that price predation is a difficult policy and enforcement area. On the one hand, the firm's decision to price lower than its competitors benefit competitors. On the other, anticompetitive harm could follow if a firm priced so "low to make it unprofitable for competitors to stay in the market and then, following [the competitors'] exits, increased price to supracompetitive levels."[12]

The Report includes a considerable debate on the frequency at which anticompetitive predatory pricing occurs, and struggles to come up with clear guidelines for businesses on how they may or may not price. First, the DOJ concludes that "average avoidable cost . . . is the best cost measure to evaluate predation claims," and the DOJ will generally rely on this theory as the appropriate measure of incremental cost.[13] Second, consistent with its view of the Supreme Court's decision in *Brook Group*,[14] the

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[9] *Verizon Commc'n, Inc. v. Law Offices of Curtis V. Trinko LLP*, 540 U.S. 398 (2004).

[10] REPORT at 45.

[11] *Id.* at 46-47.

[12] *Id.* at 49.

[13] *Id*. at 65, 67.

[14] *Brook Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993).

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DOJ is unambiguous that above-cost pricing should be *per se* legal.[15]

D. Tying—a Departure from the Per Se Standard

Tying has traditionally been treated under a modified *per se* rule of illegality. The *per se* illegality rationale has been that the monopolist may have an incentive to use a "tie" in the primary product market to monopolize the secondary product market. The Report correctly notes that tying can harm consumers in certain circumstances, but also notes that tying may lead to substantial pro-competitive efficiencies: "a firm that uses ties can have lower costs . . . than if it offered each product separately . . . [and] may benefit consumers by improving or controlling quality."[16] The DOJ thus concludes that the *per se* rule against tying is unjustified. Instead, the Report proposes that all tying arrangements be analyzed under a "new" disproportionality test. Under this test, a tying arrangement should only be deemed illegal when "(1) it has no pro-competitive benefits, or (2) if there are pro-competitive benefits, the tie produces harms substantially disproportionate to those benefits."[17]

E. Safe Harbors for Bundling and Single-Product Loyalty Discounts

The Report discusses how different U.S. Courts apply different antitrust standards to bundling and loyalty discounts, creating confusion for U.S. businesses. To help clear up this confusion, the DOJ advocates that "[c]lear and administrable standards are needed to enable firms to know in advance if bundled discounting [and loyalty discounts] may

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15 REPORT at 60.

16 *Id*. at 85.

17 *Id*. at 90.

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subject them to antitrust liability."[18]

The DOJ's solution with respect to bundling is a price-cost safe harbor, but one that will only apply if "bundle-to-bundle competition is reasonably possible."[19] If so, then the safe harbor analysis mirrors that of the predatory pricing standard, *i.e.*, the discounted price of the entire bundle must not be lower than "an appropriate measure of cost of all the products constituting the bundle."[20]

In cases where bundle-to-bundle competition is not reasonably possible, the DOJ proposes an analysis close to tying. Here, anticompetitive harm occurs if the bundled discounting would cause the customer to purchase the monopolist's bundle, instead of buying the monopoly product from the monopolist and the other product(s) from a competitor. Under this fact pattern, the DOJ proposes a discount allocation safe harbor. This test applies the discount for the entire bundle and compares it with the price of the product in the secondary product market where both the monopolist and rival compete. Even where the monopolist's bundled discounts fall outside the safe harbor, the conduct must be "analyzed for competitive effects."[21]

In almost all cases involving single product loyalty discounts, the DOJ proposed a standard predatory pricing approach, explaining that this approach has a "low risk of chilling desirable, pro-competitive price competition that immediately benefits consumers."[22]

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[18] *Id*. at 105.

[19] *Id*.

[20] *Id*.

[21] *Id*. at 102.

[22] *Id*. at 116.

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F. Refusals to Deal and Essential Facilities—Extending **Trinko** *beyond Regulated Industries*

The Report makes clear that firms are generally under no antitrust obligation to sell or license their products to competitors. Since the Supreme Court's decision in *Trinko*,[23] lower courts and antitrust practitioners have debated whether the Supreme Court intended the decision to extend beyond regulated industries.[24] The Report appears to adopt the language of the Supreme Court in a broader sense, suggesting that *Trinko* should apply to all industries. Echoing the *Trinko* decision that "*Aspen Skiing* is at or near the outer boundary of § 2 liability,"[25] the Report makes clear that the "essential facilities doctrine is a flawed means of deciding whether a unilateral, unconditional refusal to deal harms competition."[26]

[23] *Verizon Commc'n, Inc. v. Law Offices of Curtis V. Trinko LLP*, 540 U.S. 398 (2004).

[24] In *Trinko*, the Supreme Court concluded that Verizon's refusal to deal could not amount to an antitrust violation under Section 2, in part because it was subject to more stringent regulatory rules under the Telecommunications Act of 1996.

[25] *Id*. at 409.

[26] REPORT at 129.

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G. Exclusive Dealing Foreclosing Less than 30 Percent Market Share should not be Illegal

The Report notes that exclusive dealing arrangements can have both pro-competitive and anticompetitive effects, and that first step is to examine whether the arrangement has the potential to harm competition and consumers. If actual or probable harm is shown, the exclusive dealing arrangement is illegal if "(1) it has no pro-competitive benefits, or (2) if there are pro-competitive benefits, [the arrangement] produces harms substantially disproportionate to those benefits."[27] However, the DOJ proposes that exclusive arrangements, which "foreclose less than thirty percent of existing customers of effective distribution should not be illegal."[28]

III. ARE THERE ANY LASTING IMPLICATIONS OF THE REPORT?

It remains to be seen whether the DOJ's Report will have any lasting implications. The FTC's public disagreement demonstrates that there continues to be much room for debate regarding Section 2 enforcement policies. Both antitrust agencies take their roles seriously and their enforcement motives are not to be questioned. The current debate is more about what road to take and how fast to drive. Ultimately, it will be the courts that decide many of these issues, and the common law of antitrust has proven to have a lengthy incubation period in the courts. Thus, many of the proposed guidelines and bright-line tests proposed by the DOJ will continue to be tested in the U.S. courts.

Chairman Kovacic's view about placing these issues into historical context to

[27] *Id*. at 140.

[28] *Id*.

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help understand where we may be going is especially prescient in light of the upcoming general election. The Report was released less than two months before the U.S. elects a new president, and coincides with a global economic crisis. These events may well have more of an impact on future enforcement of Section 2 than the current debate between the DOJ and FTC.

Commenting on the DOJ Report, the Barack Obama campaign noted that "[f]our more years of the Bush-McCain approach to antitrust will only lead to higher prices for American consumers and a less competitive environment for smaller businesses to thrive."[29] In a statement for the American Antitrust Institute, Senator Barack Obama opined that "the current administration has what may be the weakest record of antitrust enforcement of any administration in the last half century, . . . [and in the last] seven years, the Bush Justice Department has not brought a single monopolization case."[30]

Senator John McCain has yet to spell out his position on the Report. Senator McCain has stated that he is a "strong supporter of our antitrust laws [believing] they should be vigorously enforced."[31]

Again, much like the antitrust agencies divergent views on enforcement, neither candidate's intent to enforce the antitrust laws, and particularly Section 2, should be called into question. Rather the debate will continue to play out as a new administration takes over and chooses which way to turn, toward the DOJ's positions laid out in the Report, or the FTC's divergent views expressed in its Statement.

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29 Eric Lichtblau, *Antitrust Document Exposes Rift*, N.Y. TIMES, Sept. 9, 2008, at C1.

30 Statement from Senator Barack Obama to the American Antitrust Institute (Sept. 27, 2007).

31 Senator John McCain, Remarks in Wilmington, OH (Aug. 7, 2008).

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The safest approach is to look at the Report as the DOJ's current enforcement policy on unilateral conduct rather than a clear shift in how Section 2 is applied to single-firm conduct. In the end, the divergent views between the DOJ and FTC are likely to be just another skirmish in a continuing debate on antitrust enforcement policies.

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