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The Justice Department's Section 2 Report: The Widening Schism on Pennsylvania Avenue

William Kolasky *

The Justice Department ("DOJ")'s Section 2 report ("Report")[1] and the Federal Trade Commission ("FTC")'s sharp reaction leave practitioners in the perplexing situation where there seems to be strong disagreement between our two federal antitrust enforcement agencies over what standards should apply to single-firm conduct under Section 2 of the Sherman Act.[2] This not only makes counseling more difficult than ever, but it also severely undermines the ability of our U.S. antitrust enforcers to play a role in shaping global antitrust policy toward single-firm conduct, an area in which many of us have long observed we already have a wide divergence between the United States and European courts.

I think the primary result will be one that was suggested by Chairman Kovacic in his separate statement—more discussion, and unfortunately little resolution. In the interest of trying to move that discussion forward and perhaps even heal the schism, I

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

[2] 15 U.S.C. § 2.

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have a few overarching observations to share.

In my view, the Report, overall, is quite well done. It discusses what everyone acknowledges are very difficult issues in a well-informed and careful manner, and the approaches it proposes to take to the particular types of conduct it discusses (price predation, tying, bundled and loyalty discounts, refusals to deal, and exclusive dealing) seem generally sound in the sense of identifying the right issues to be examined in individual cases.

Where the Report veers off course—and where the comments from the majority of the FTC commissioners have the most persuasive force—is in the general standards it proposes for exclusionary conduct. The Report lays out a false set of just three choices for applying Section 2—what it calls an effects balancing test, a no economic sense test, and an equally efficient competitor test. It concludes that each test has something to offer, but then it proposes a new "substantial disproportionality test," under which the DOJ will bring a case only if it concludes not just that the conduct harms consumers and competition, but that this harm is "substantially disproportionate" to any legitimate benefits the monopolist or near-monopolist stands to realize. In adopting this test, the DOJ, in effect, puts its finger on the scale in the favor of monopolists—doing so, it says, because it views the risk of false positives as more serious than that of false negatives.

Assuming this standard reflects the enforcement policy of the current administration at the DOJ, it is easy to understand why the DOJ has not brought a

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single monopolization case in eight years. In my view, this test undermines the goals of Section 2 and encourages firms with market power to game the antitrust laws. The determination of what constitutes a "substantially disproportionate" effect—itself a nebulous term—can not be made until years later, after the effects are already apparent and after a lengthy trial and appeal. Monopolists with bad intent might be encouraged to engage in bad behavior given the potential that they can get away with their conduct.

I have advocated instead using the same rule of reason analytical framework that is currently used to evaluate concerted conduct under Section 1 for single-firm conduct by monopolists and near-monopolists under Section 2. The Report mischaracterizes this rule of reason analytical framework as an "effects-balancing" test, which they criticize as too "open-ended." This characterization reflects a fundamental misunderstanding of how the courts actually apply the rule of reason under Section 1.

As the Supreme Court explained in *California Dental Ass'n v. F.T.C.,*[3] citing a dialogue I had with Joel Klein when he was Assistant Attorney General, the courts apply the rule of reason through a stepwise approach, which requires a sliding scale at each step of the analysis, in order to avoid the need to engage in the type of ad hoc balancing the DOJ fears. Under this stepwise, sliding scale framework, a court first examines the alleged anticompetitive effects to determine whether they are substantial enough to justify shifting the burden to the defendant of having to explain its conduct.

[3] California Dental Ass'n v. F.T.C., 526 U.S. 756, 779-81 & n.15 (1999).

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If they are, the court will then require the defendant to come forward with pro-competitive justifications for the alleged conduct. The more serious the anticompetitive effects, the more closely the court will scrutinize any proffered justifications to determine whether they are pretextual. Assuming they are not, the court will then require the plaintiff to come forward with less restrictive alternatives that might have achieved the defendant's legitimate objectives at less cost to competition. Again, how hard the court will search for less restrictive alternatives, and how closely it will scrutinize them, depends on how strong the prior showing of anticompetitive effects and pro-competitive justifications have been. Taking this stepwise approach, the courts never actually have to engage in any ad hoc balancing of the anticompetitive and pro-competitive effects to determine their net impact on consumer welfare—a nearly impossible task.

As I have written elsewhere,[4] this rule of reason analytical framework, as it was first developed by the Supreme Court in *Standard Oil Co. v. United States*,[5] was intended to apply equally to both sections. Since then, the courts have done an excellent job in Section 1 cases refining this analytical framework by adopting a well-structured stepwise inquiry that eliminates the need to engage in the type of ad hoc balancing of effects that the DOJ seems so greatly to fear and that drives them to their "substantial disproportionality" test.

As I have also explained previously, this is exactly the same analytical

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[4]*See* William Kolasky, *Reinvigorating Antitrust Enforcement In The United States: A Proposal*, ANTITRUST, Spring 2008, at 89.

[5]Standard Oil Co. v. United States, 221 U.S. 1 (1911).

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framework the Supreme Court has evolved over the last fifty years to structure its application of the constitutional protections of the Bill of Rights as extended to the states by the Fourteenth Amendment. There, the Supreme Court expressly conditions the degree of scrutiny to which it will subject proffered justifications for government conduct on the nature of the conduct and the extent to which it infringes on important rights.

I have to agree with Chairman Kovacic that there should have been a "deeper empirical examination of how the operation of private rights affects business decision[s]" before reaching the conclusion that the fear of the rule of reason test will lead to the false positives feared by the DOJ. When one examines Section 2 decisions in the Supreme Court and the courts of appeals over the last quarter century, it is hard to argue that the danger of false positives outweighs the danger of false negatives. One can almost count on one hand the number of Section 2 cases plaintiffs have won, and most of those—like *Conwood Co. v. U.S. Tobacco Co.*[6] and *United States v. Microsoft Corp.*[7]—are cases that the overwhelming consensus of antitrust lawyers and economists agree were rightly decided. Similarly, in counseling clients over more than thirty years, I can think of no occasion in which any client has been deterred from undertaking pro-competitive conduct because of fear of antitrust liability.

We have an election coming up in November. It is likely whichever candidate wins the election that we will have new leadership at least at the DOJ and perhaps at

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[6] Conwood Co. v. U.S. Tobacco Co, 290 F.3d 768 (6th Cir. 2002).

[7] United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001).

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both agencies. I join Chairman Kovacic in urging that the two agencies stop shouting at each other over these important issues and that we have a further civilized discussion about them. In this regard, it would have been very helpful had the DOJ released its report first as a discussion draft as the European Commission did with its Article 82 report so that we could have had such a discussion before one agency preemptively announced its policy only to have the other agency loudly proclaim its disagreement, while the rest of us stand by slack-jawed.

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