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Exclusionary Conduct in Antitrust

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EXCLUSIONARY CONDUCT IN ANTITRUST

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INTRODUCTION

American society has a long history of encouraging competition and a long history of abhorring monopoly. Often those two goals are complementary, but not always. What happens if a company competes so aggressively that it wipes out its competitors and gets a monopoly? Is that good or bad? The easy answer is that normal competition is fine, but unfair or predatory competition is not. But that easy answer is not particularly helpful. It is often very hard to distinguish the good from the bad. Low prices are good, right? But what if they are below cost so that rivals cannot compete?

Courts and commentators have struggled hard for many decades to develop rules that separate the lawful conduct of a single firm from the unlawful. That struggle continues today. We trace a bit of the history of this struggle, summarize where the courts are today, and then offer a few suggestions for a path going forward.

I. HISTORICAL BACKGROUND

While "exclusionary" or "predatory" conduct lies at the heart of antitrust law's single firm proscription,[1] the precise definitions of these terms have evaded and intrigued courts and scholars

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[1] The governing statute, section 2 of the Sherman Act, 15 U.S.C. § 2 (2012), provides in part: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . ." The statute has not been used criminally for decades.

and have been the source of much consternation for decades.[2] Courts have repeatedly recognized that "[w]hether any particular act of a monopolist is exclusionary, rather than merely a form of vigorous competition, can be difficult to discern: the means of illicit exclusion, like the means of legitimate competition, are myriad."[3] Analyzing the derivations of the exclusionary conduct concept and its tumultuous development over the past 120 years is, therefore, useful to understanding how antitrust law regards single-firm conduct today—and especially to attempting to separate the conduct we encourage from the behavior we condemn.

We begin at the beginning. Congress passed the Sherman Act in 1890 in response to a rash of corporate consolidations and a growing perception that the "trusts" being created threatened to impair the free market economy and to impose upon the country a system comprised solely of behemoth businesses well-poised to exploit the population at large.[4] The expansion of these "great trusts" had accelerated in the dozen or so years leading up to 1890—with well-despised trusts such as Standard Oil[5] and American Tobacco,[6] as well as the Beef,[7] Sugar,[8] and Gunpowder[9] trusts, seeming to proliferate. These and other

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[2] *See, e.g.*, Telex Corp. v. Int'l Bus. Machs. Corp., 510 F.2d 894, 927 (10th Cir. 1975) (noting the term "predatory" "probably does not have a well-defined meaning in the context it was used, but it certainly bears a sinister connotation").

[3] *See, e.g.*, United States v. Microsoft Corp., 253 F.3d 34, 58 (D.C. Cir. 2001) (per curiam); Caribbean Broad. Sys., Ltd. v. Cable & Wireless PLC, 148 F.3d 1080, 1087 (D.C. Cir. 1998) (" 'Anticompetitive conduct' can come in too many different forms, and is too dependent upon context, for any court or commentator ever to have enumerated all the varieties.").

[4] *See, e.g.*, EDWARD BELLAMY, LOOKING BACKWARD 2000-1887, at 127 (John L. Thomas ed., Harvard Univ. Press 1967) (predicting the tendency toward trusts would persist until society would be transformed into one great trust); Sanford D. Gordon, *Attitudes Towards Trusts Prior to the Sherman Act*, 30 S. ECON. J. 156, 159 (1963) (detailing the growing concern across various sectors of the country with the problem of the great trusts and noting that thirteen states passed antitrust legislation before Congress passed the Sherman Act, but that when the states enforced their antitrust laws, the trusts would merely "incorporate[] in other states and continue[] their activities as they had done before the court's decisions"); Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 65, 82–83 (1982).

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

[6] *See, e.g.*, Am. Tobacco Co. v. United States, 221 U.S. 106 (1911).

[7] *See, e.g.*, Swift & Co. v. United States, 196 U.S. 375 (1905).

[8] *See, e.g.*, United States v. E.C. Knight Co., 156 U.S. 1 (1895).

[9] *See, e.g.*, United States v. E.I. du Pont de Nemours & Co., 188 F. 127 (C.C.D. Del. 1911).

trusts monopolized their industries, raised prices, and excluded competitors.[10] And their abuses, both realized and potential, created a political firestorm.[11]

Enter the Sherman Act. A relatively simple statute—especially compared to many of its modern counterparts—the Sherman Act was intended, in part, to codify common law at the federal level.[12] It was comprised of two main sections. Section 1 was directed at combinations or conspiracies among two or more actors.[13] Section 2—which was not a codification of common law principles—was directed at efforts to monopolize by a single firm or firms, that is, unilateral conduct.[14] Despite its apparent simplicity, the Sherman Act had the capacity to encompass a multitude of anticompetitive sins.[15]

While it was utilized in its first several decades to address the problem of the original great trusts, the Act's development outside this narrow arena—that is, where large corporate consolidations yielded firms of monopoly size that engaged in abusive conduct[16]—occurred more slowly.[17] Its broad language left open for development the concept of "monopolization" and its myriad manifestations and abuses, but the many gaps were not immediately filled.[18] For the first sixty years following its

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[10] *See, e.g.*, *id.* at 151–52.

[11] *See* HANS B. THORELLI, THE FEDERAL ANTITRUST POLICY 163 (1954); *see also* United States v. Griffith, 334 U.S. 100, 107 (1948) ("[M]onopoly power, whether lawfully or unlawfully acquired, may itself constitute an evil and stand condemned under s 2 even though it remains unexercised.").

[12] *E.g.*, State Oil Co. v. Khan, 522 U.S. 3, 20–21 (1997); United States v. Associated Press, 52 F. Supp. 362, 370 (S.D.N.Y. 1943) (L. Hand, J.), *aff'd*, 326 U.S. 1 (1945).

[13] Sherman Antitrust Act ch. 647, § 1, 26 Stat. 209 (1890) (codified at 15 U.S.C. § 1 (2012)).

[14] Ch. 647, § 2, 26 Stat. 209 (1890) (codified at 15 U.S.C. § 2 (2012)).

[15] *See* Am. Tobacco Co. v. United States, 221 U.S. 106, 181 (1911) ("[T]he generic designation of the 1st and 2d sections of the law, when taken together, embraced every conceivable act which could possibly come within the spirit or purpose of the prohibitions of the law, without regard to the garb in which such acts were clothed.").

[16] Aaron Director & Edward H. Levi, *Law and the Future: Trade Regulation*, 51 NW. U. L. REV. 281, 282–83 (1956); *see also* N. Sec. Co. v. United States, 193 U.S. 197, 356–58 (1904) (holding by a 5-4 majority that the Sherman Act applies to stock acquisitions).

[17] Director & Levi, *supra* note 16, at 282.

[18] Jonathan M. Jacobson & Tracy Greer, *Twenty-One Years of Antitrust Injury: Down the Alley with* Brunswick v. Pueblo Bowl-O-Mat, 66 ANTITRUST L.J. 273, 274–75 (1998).

passage, for example, there was some, but very little, private enforcement.[19] The Act as originally enacted contained the now well-known treble damages remedy for private enforcement,[20] but only 157 treble damages actions were recorded between 1899 and 1939, with only fourteen plaintiffs recovering less than $275,000 total.[21]

Indeed, the first truly significant single-firm conduct case—the U.S. Department of Justice's ("DOJ") case against Alcoa—was not initiated until 1938, almost fifty years after the Act was passed.[22] This case yielded one of the most significant precedents within antitrust law: an opinion by Judge Learned Hand in 1945 for the Second Circuit.[23] That court was sitting as the court of last resort by special act of Congress because the Supreme Court lacked a quorum.[24] The court famously held that a firm that intentionally acquires monopoly power violates section 2.[25] Following decades of dominance, the DOJ had accused Alcoa of monopolizing the aluminum ingot market, and the court concluded Alcoa's control of this market exceeded ninety percent.[26] After rendering this conclusion, the court turned to evaluating whether Alcoa violated the Sherman Act.[27] The court noted that, merely because Alcoa had achieved such monopoly power, it did not necessarily violate section 2, recognizing that "[t]he successful competitor, having been urged to compete, must not be turned upon when he wins."[28] Nonetheless, given the touchstone of intent, the court quickly concluded Alcoa had unlawfully monopolized the aluminum ingot market principally by expanding its production capacity such that consumers did not need to turn to Alcoa's competitors for supply.[29] Thus, the court ultimately held that unless monopoly

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[19] *Id.* at 275.

[20] Sherman Antitrust Act, ch. 647, § 7, 26 Stat. 209 (1890) (repealed 1914).

[21] Jacobson & Greer, *supra* note 18, at 275 & n.16.

[22] United States v. Aluminum Co. of Am., 148 F.2d 416, 421 (2d Cir. 1945) [hereinafter *Alcoa*].

[23] *Id.*

[24] Act of June 9, 1944, ch. 239, 58 Stat. 272, *amended by* Act of Dec. 21, 1974, Pub. L. No. 93–528, 88 Stat. 1706.

[25] *Alcoa*, 148 F.2d at 431–32.

[26] *Id.* at 425.

[27] *Id.* at 426–32.

[28] *Id.* at 429–30.

[29] *Id.* at 431 ("It was not inevitable that [Alcoa] should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing

was "thrust upon" Alcoa or "merely [the result] of . . . skill, foresight and industry," the act of monopolization was intentional and therefore unlawful.[30]

The court's conception of monopolization in *United States v. Aluminum Co. of America*[31] ("*Alcoa*") became the leading standard, reigning supreme from its first articulation through the 1970s. It was adopted and reiterated by the courts, and was largely codified in the Court's 1966 decision in *United States v. Grinnell Corp*.[32] In that case, the Supreme Court articulated the monopolization formula still used today, holding that unlawful monopolization is "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."[33] The effect of applying the *Alcoa* rule under this articulation was that, once monopoly power was proven, it was difficult for any defendant to avoid condemnation under section 2.

This rule and its effect were informed by developments occurring in the area of price discrimination under the Clayton Act and the 1936 amendments known as the Robinson-Patman Act.[34] The pervading sense in this early era was that selective price cutting that damaged rivals was harmful in and of itself.[35] This sense largely derived from the understanding that it was unfair for large buyers to receive discounts simply because they were large, and that small businesses should be protected against such unwarranted disparity of treatment.[36] As such, the

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compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors, but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel.").

[30] *Id.* at 430.

[31] *See generally id.*

[32] 384 U.S. 563, 570–71 (1966).

[33] *Id.* The phrasing drew from the government's brief. *See* Brief for the United States at 41, United States v. Grinnell Corp., 384 U.S. 563 (1966) ("[T]he willful acquisition or maintenance of that power, i.e., that such power was not 'thrust upon' its possessor.") (citation omitted).

[34] 15 U.S.C. § 13(a) (2012).

[35] *See generally* LOUIS D. BRANDEIS, THE CURSE OF BIGNESS (1934).

[36] *See, e.g.*, Fed. Trade Comm'n v. Morton Salt Co., 334 U.S. 37, 43 (1948) ("The legislative history of the Robinson-Patman Act makes it abundantly clear that

Clayton Act was passed in 1914, "born of a desire by Congress to curb the use by financially powerful corporations of localized price-cutting tactics which had gravely impaired the competitive position of other sellers."[37] Finding this Act, alone, unsatisfactory, Congress soon after supplemented it with the Robinson-Patman Act, which "was aimed at a specific weapon of the monopolist—predatory pricing."[38] The Robinson-Patman Act attacked predatory pricing by prohibiting price discrimination "between different purchasers of commodities of like grade and quality";[39] this prohibition meant a supplier was foreclosed both from charging lower prices in certain geographic areas while leaving prices intact in other areas, so as to leverage its market power and drive competitors out of business, and from offering buyers volume discounts, among other things.[40]

Reflecting the animosity toward price discrimination characteristic of the time, courts applying the Robinson-Patman Act quickly made clear that—unlike today—civil predatory pricing claims under the Robinson-Patman Act did not require a demonstration that the defendant's prices were below cost.[41] Rather, the courts consistently held that many varieties of price cutting to one or more, but not all, buyers were unlawful. The Supreme Court in *FTC v. Anheuser-Busch, Inc.*,[42] for instance, noted that the Court had consistently defined "price discrimination" for Robinson-Patman purposes as "merely a price difference."[43] As many have noted since, this definition denied

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Congress considered it to be an evil that a large buyer could secure a competitive advantage over a small buyer solely because of the large buyer's quantity purchasing ability. The Robinson-Patman Act was passed to deprive a large buyer of such advantages . . . .").

[37] Fed. Trade Comm'n v. Anheuser-Busch, Inc., 363 U.S. 536, 543 (1960).

[38] United States v. Nat'l Dairy Prods. Corp., 372 U.S. 29, 33–34 (1963).

[39] 15 U.S.C. § 13(a).

[40] *Id.*

[41] *Anheuser-Busch, Inc.*, 363 U.S. at 547–48; Moore v. Mead's Fine Bread Co., 348 U.S. 115, 119–20 (1954); Cont'l Baking Co. v. Old Homestead Bread Co., 476 F.2d 97, 104 (10th Cir. 1973); Nat'l Dairy Prods. Corp. v. Fed. Trade Comm'n , 412 F.2d 605, 616 (7th Cir. 1969). Criminal Robinson-Patman claims did require a demonstration of below-cost pricing. *Nat'l Dairy Prods. Corp.*, 372 U.S. at 33–34 (1963).

[42] 363 U.S. 536.

[43] *Id.* at 549 ("When this Court has spoken of price discrimination in s 2(a) cases, it has generally assumed that the term was synonymous with price differentiation."); *see also* Fed. Trade Comm'n v. Morton Salt Co., 334 U.S. 37, 44–45 (1948) (identifying the "avowed purpose" of the Robinson-Patman Amendment as "protect[ing] competition from all price differentials except those based in full on cost

large buyers the benefits of economies of scale and otherwise eliminated the beneficial effects that price discrimination could offer.[44] Given this emblematic backdrop, many cases seemingly illogical to us today were fairly commonplace throughout this period.[45]

Indeed, much of the conduct that is universally recognized as enhancing consumer welfare today was condemned as unlawful monopolization in the *Alcoa* era. In *Utah Pie Co. v. Continental Baking Co.*,[46] for example, the Court analyzed claims that the defendants violated the antitrust laws by lowering their prices on frozen pies in order to entice distributor grocery stores into buying their pies rather than their competitors' and creating what the Court called a "declining price structure."[47] The court concluded these allegations, along with evidence that distributors did, in fact, buy more of the defendants' pies, were sufficient to support an antitrust violation.[48] In holding that "a competitor who is forced to reduce his price to a new all-time low in a market of declining prices will in time feel the financial pinch and will be a less effective competitive force," the Court essentially entirely discounted the consumer welfare benefits attendant to the lower prices and increased output deriving from this price competition.[49] Today, it is unfathomable that a

savings" to the supplier, and holding "Congress meant by using the words 'discrimination in price' in s 2 that in a case involving competitive injury between a seller's customers the Commission need only prove that a seller had charged one purchaser a higher price for like goods than he had charged one or more of the purchaser's competitors"); Fed. Trade Comm'n v. Cement Inst., 333 U.S. 683, 721 (1948) (defining "discrimination in price" as "selling the same kind of goods cheaper to one purchaser than to another"); Moss v. Fed. Trade Comm'n, 148 F.2d 378, 379 (2d Cir. 1945) (holding that proof of a price differential itself constituted "discrimination in price," where the competitive injury in question was between sellers).

[44] *See, e.g.*, D. Daniel Sokol, *The Transformation of Vertical Restraints: Per Se Illegality, the Rule of Reason and Per Se Legality*, 79 ANTITRUST L.J. 1003, 1012–13 (2014).

[45] Scholars have documented the significant shift in application of the Robinson-Patman Act since its first enactment. *See, e.g.*, Ryan Luchs et al., *The End of the Robinson-Patman Act? Evidence from Legal Case Data*, 56 MGMT. SCI. 2123 (2010); D. Daniel Sokol, *Analyzing Robinson Patman*, GEO. WASH. L. REV. (forthcoming 2015).

[46] 386 U.S. 685 (1967).

[47] *Id.* at 689–91, 703.

[48] *Id.* at 699–700 (decided under the Robinson-Patman Act, applying Sherman Act principles).

[49] *Id.*

competitor could successfully bring such a case; modern courts are, rightfully, quite skeptical of antitrust allegations in which the alleged anticompetitive conduct is the defendant's price decreases. Price competition is the paradigmatic consumer benefit of competitive markets and only in the rarest of instances entails a real potential for anticompetitive harms. But, in the late 1960s, this line of analysis had yet to be adopted by the courts.[50]

II. INFLUENCE OF CHICAGO ECONOMICS

Largely owing to cases like *Utah Pie*, antitrust law became a focal point for many law and economics scholars from the 1950s forward. These scholars analyzed the current state of the law and, in many cases, found antitrust to be a meandering and incoherent jumble.[51] Their findings led to serious academic challenges to the *Alcoa-Grinnell* paradigm and to a strong push to incorporate microeconomic principles into antitrust analysis.[52] What is known as the "Chicago School" was at the forefront of these challenges.[53]

Rigorous debates, led by prominent scholars at the University of Chicago and spearheaded by Aaron Director, called into question the very foundations of antitrust law as it had been adopted and implemented by the courts.[54] These scholars derided antitrust's internal inconsistencies, and proffered that tethering

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[50] *See* United States v. Nat'l Dairy Prods. Corp., 372 U.S. 29, 33–34 (1963).

[51] *See, e.g.*, Edward D. Cavanagh, *Antitrust Law and Economic Theory: Finding a Balance*, 45 LOY. U. CHI. L.J. 123, 125–29 (2013).

[52] For an excellent history and analysis of the integration of economics into antitrust law, see *id.* at 130–48.

[53] *Id.* at 140–41.

[54] *See* RICHARD A. POSNER & FRANK H. EASTERBROOK, ANTITRUST: CASES, ECONOMIC NOTES AND OTHER MATERIALS xvi (2d ed. 1981) ("Much of the economic analysis expounded in these notes is based on ideas first proposed by Director. A number of these ideas were later developed and published by other economists whose work we cite, but these citations conceal Director's seminal role in the development of the economics of competition and monopoly presented in this book."); Bruce H. Kobayashi & Timothy J. Muris, *Chicago, Post-Chicago, and Beyond: Time To Let Go of the 20th Century*, 78 ANTITRUST L.J. 147, 150 (2012) ("The historical accounts of the Chicago School of Antitrust uniformly agree on the central influence of Aaron Director and the Antitrust Law course he taught with Edward Levi at the University of Chicago."); William H. Page, *The Chicago School and the Evolution of Antitrust: Characterization, Antitrust Injury, and Evidentiary Sufficiency*, 75 VA. L. REV. 1221, 1229–30 (1989). *See generally* Director & Levi, *supra* note 16; Sam Peltzman, *Aaron Director's Influence on Antitrust Policy*, 48 J.L. & ECON. 313 (2005).

antitrust law to economic analysis would bring the order and consistency for which they believed antitrust was so desperate. Director and Levi, for example, criticized the inherent tension in *Alcoa*—which espoused the importance of not turning upon the successful competitor but went on to do just that—noting rather tongue-in-cheekily that "[p]erhaps . . . the successful competitor can be turned upon when he wins, because he has been told not to compete."[55]

Director's and others' critiques, in turn, sparked the famous "Fortune Magazine Debates," a series of papers with Robert H. Bork and Ward S. Bowman, Jr. on one side, arguing that the time had come for an antitrust reckoning, and Harlan H. Blake and William K. Jones on the other, defending antitrust law largely as it was.[56] Following Director and Levi, Bork and Bowman contended there existed "a fundamental and widespread misconception of the nature and virtues of the competitive process," and argued that the true value of competition lay in its ability to "provide[] society with the maximum output that can be achieved at any given time with the resources at its command."[57] Blake and Jones, meanwhile, argued competition should be protected for reasons other than economic efficiency; political objectives, such as protecting individual freedom and opportunity, were, in their view, worthy antitrust goals.[58]

Ultimately, many of Bork and Bowman's positions were embraced by antitrust law more broadly. Bork expanded upon the issues in his seminal book, *The Antitrust Paradox: A Policy at*

[55] Director & Levi, *supra* note 16, at 286. Director did not publish his antitrust analysis. This *Law and the Future* paper, written largely by Levi, is his only significant published work. His influence instead was carried orally, first by himself, and later by his many followers, most prominently Robert Bork.

[56] *See* Harlan M. Blake & William K. Jones, *In Defense of Antitrust*, 65 COLUM. L. REV. 377 (1965); Harlan M. Blake & William K. Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 COLUM. L. REV. 422 (1965); Robert H. Bork & Ward S. Bowman, Jr., *The Crisis in Antitrust*, 65 COLUM. L. REV. 363 (1965); Robert H. Bork, *Contrasts in Antitrust Theory: I*, 65 COLUM. L. REV. 401 (1965); Ward S. Bowman, *Contrasts in Antitrust Theory: II*, 65 COLUM. L. REV. 417 (1965).

[57] Bork & Bowman, *supra* note 56, at 364–65. Competition, they proffered, could conceivably be injured when either (1) consenting parties purposefully eliminate competition by, for example, agreement, acquisition, or merger, or (2) competitors compete too successfully and injure their rivals. Only the first scenario should be protected by antitrust laws, because doing so promotes the efficient allocation of resources, while the second protects less efficient competitors, keeping prices high and output low. *See* Bork, *supra* note 56, at 401–02.

[58] Blake & Jones, *supra* note 56, at 427–36.

War with Itself.[59] Here, Bork more fully explicated his argument that antitrust law, as developed by the courts, suffered from fatal internal conflicts—or, more colorfully, from schizophrenia.[60] Rather than considering the protection of competitors—which led to odd scenarios such as *Utah Pie* where the courts condemned conduct that benefited consumers but harmed certain competitors—Bork argued antitrust should seek to protect consumers.[61] He proffered that the Sherman Act was designed as a "consumer welfare prescription," and that, both as policy and economic matters, focusing upon consumer welfare was the solution for resolving antitrust's inconsistencies.[62] He underscored the point by observing that having multiple diffuse goals makes antitrust unworkable.[63] While protecting competitors meant keeping prices high and output low, the precise conditions occurring in monopolistic, anticompetitive markets, protecting consumers also promoted price decreases, output increases, and enhancements in services and product quality.

The argument that antitrust should protect consumers—that is, that it should encourage lower prices, higher production, better quality, faster innovation, and so forth—was the key contribution of the Chicago School.[64] The Chicago School rejected the idea that protecting competitors was an acceptable purpose of antitrust law.[65] If competitors lost opportunities because they were less efficient, that was a good thing, not a bad one.

The Chicago School's world view was informed predominantly by (1) economic teachings and (2) the error cost framework.[66] Chicagoans believed antitrust law should be informed by, and respond to, what economic theory and empirical

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[59] *See generally* ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (1993).

[60] Bork & Bowman, *supra* note 56, at 364.

[61] BORK, *supra* note 59, at 66.

[62] *Id.* Bork's concept of "consumer welfare," a new phrase at the time, was a shorthand for "the total welfare of all consumers as a class." *Id.* at 110. That concept should be distinguished from "consumer welfare" in the economic sense of "consumer surplus." *See* Gregory J. Werden, *Antitrust's Rule of Reason: Only Competition Matters*, 79 ANTITRUST L.J. 713, 718–26 (2014).

[63] BORK, *supra* note 59, at 50.

[64] *Id.* at xi.

[65] *Id.* at 50–51.

[66] Page, *supra* note 54, at 1240–41.

evidence suggested regarding particular conduct.[67] Economic theory could illuminate the circumstances under which certain behaviors were likely to yield anticompetitive effects, while empirical evidence could demonstrate how often, in fact, such circumstances occurred and whether they did or did not dampen competition.[68]

The error cost framework, meanwhile, posited that Type I, false positive, errors in antitrust enforcement—which erroneously condemn procompetitive behavior—would be far more costly than Type II, false negative, errors, or those that fail to punish anticompetitive behavior.[69] Erroneous imposition of antitrust liability, it was argued, not only eliminates competitive actions of the firm facing liability, thereby reducing the level of competition within that industry, but further has a reverberating effect across the economy.[70] The chilling effects of erroneous condemnation may be quite severe: Because antitrust trebles damages, similarly situated firms are sure to stay far afield of any procompetitive behaviors resembling those previously condemned, meaning that levels of competition outside of the industry at issue may also diminish in response.[71] Type II errors, on the other hand, allow anticompetitive actions to persist. Chicagoans argued—based on theory rather than empirics—that these errors raise fewer concerns as such anticompetitive behavior can yield above average returns, thereby attracting new entry and more competition.[72] In other words, they argued, we can expect the industry to experience some degree of self-correction over time.[73] Combined, the error cost framework and reliance upon economics yielded a prescription for antitrust law that was far more hands-off than antitrust had historically been.

The Chicago School's suggestions were largely, but not entirely, successful. Its notions that antitrust should take its cues from economic teachings and strive to preserve competition, not competitors, rapidly ascended, promoted by prominent

[67] BORK, *supra* note 59, at 430.
[68] Page, *supra* note 54, at 1242.
[69] *Id.* at 1243.
[70] Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 15–16 (1984).
[71] *Id.* at 34.
[72] *Id.* at 15.
[73] *Id.*

Chicagoans like Lester Telser,[74] John McGee,[75] and, later, Richard Posner[76] and Frank Easterbrook.[77] As developed below, the courts endorsed and adopted a number of these views and continue to rely upon many of these insights today.

More controversial was orthodox Chicagoans' proposal for a total welfare approach to antitrust. Although they used the term "consumer welfare," these scholars actually endorsed an approach under which a wealth transfer from consumers to producers, alone, should not be actionable.[78] For these orthodox Chicagoans, efficiency was the only proper goal of antitrust law; the evil of monopolization was considered to be the so-called "deadweight loss" that arises when firms with monopoly power restrict output and increase prices.[79] Enforcement, under this view, was to be limited to those contexts in which the conduct yielded a deadweight welfare loss.[80] If, for example, certain behavior merely transferred benefits from consumers to producers, thereby resulting in a producer surplus but no deadweight loss to society, this result was efficient to the market overall and should be recognized as such.[81]

This paradigm was intended to be, and was, a recipe for laissez-faire. While the degree to which Chicago scholars embraced the laissez-faire approach varied, many advocated for a strong hands-off policy towards exclusionary conduct—apart from cartels and mergers to monopoly.[82] These scholars proffered the laissez-faire approach should succeed even in cases where a

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[74] *See, e.g.*, Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3. J.L. & ECON. 86 (1960).

[75] *See, e.g.*, John S. McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case*, 1 J.L. & ECON. 137, 137–38 (1958).

[76] *See, e.g.*, RICHARD A. POSNER, ANTITRUST LAW (2d ed. 2001).

[77] *See, e.g.*, Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984).

[78] BORK, *supra* note 59, at 66, 97; *see, e.g.*, Ken Heyer, *Robert Bork and Welfare Standards*, J.L. & ECON. (forthcoming 2015); Lande, *supra* note 4, at 75; Sokol, *supra* note 44, at 1007–08.

[79] BORK, *supra* note 59, at 101.

[80] *See id.*

[81] *Id.*

[82] *See, e.g.*, Kobayashi & Muris, *supra* note 54, at 154 ("The early Chicago School analyses did produce nearly uniform results in rejecting the existing, non-economic-based antitrust doctrine of the 1960s. But agreement on what not to do does not mean agreement on what to do."); Joshua D. Wright, *Abandoning Antitrust's Chicago Obsession: The Case for Evidence-Based Antitrust*, 78 ANTITRUST L.J. 241, 244–45 (2012) (noting the "heterogeneity in both economic approaches and policy prescriptions" within the Chicago school).

deadweight loss was a real prospect, proposing such rules as banning competitor lawsuits[83] and per se legality for vertical restraints.[84] To these scholars, the risks attendant to misdiagnosing and condemning anticompetitive conduct outweighed the potential benefits of correctly capturing truly anticompetitive conduct, which was perceived to occur comparatively infrequently.

The Chicago School's general adoption of the laissez-faire approach is often contrasted to the "Harvard" School's approach, which developed at the same time. Scholars within the Harvard School largely agreed with the call for antitrust to employ an economic approach but did not at all agree with the ultimate laissez-faire prescription.[85] Impactful scholars such as Phillip Areeda, Donald F. Turner, and Herbert Hovenkamp[86] recognized the troubles plaguing antitrust, but proffered an approach allowing for a more hands-on response to potential competition issues. Like the orthodox Chicago scholars, their work contributed significantly to antitrust law's overhaul. Areeda and Turner's article on predatory pricing under section 2, for instance, is one of the most influential pieces in the history of American law.[87] The combination of efforts from the Chicago and Harvard schools pushing for an antitrust regime tied to economic

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[83] Easterbrook, *supra* note 70, at 34–37.

[84] BORK, *supra* note 59, at 288 ("[E]very vertical restraint should be completely lawful."); Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 9, 23–26 (1981).

[85] For example, Areeda and Turner likewise noted the dangers of allowing competitor suits, specifically in the context of predatory pricing claims. *See* Phillip Areeda & Donald F. Turner, *Predatory Pricing and Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 699 (1975) (arguing that in framing antitrust rules for predatory pricing "extreme care be taken . . . lest the threat of litigation, particularly by private parties, materially deter legitimate, competitive pricing").

[86] While Herbert Hovenkamp is largely associated with the Harvard School, in some of his writings he appears to take a more Chicagoan tact. *See, e.g.*, HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION (2005).

[87] Areeda & Turner, *supra* note 85, at 698 (articulating the now well-understood notion that "predatory pricing would make little economic sense to a potential predator unless he had (1) greater financial staying power than his rivals, and (2) a very substantial prospect that the losses he incurs in the predatory campaign will be exceeded by the profits to be earned after his rivals have been destroyed").

analysis—which both aligned with economic theory and reacted to empirical evidence—brought meaningful and lasting change to antitrust.[88]

III. THE JUDICIAL RESPONSE

Over the course of the period from the mid 1970s to the present, the law applicable to dominant firm conduct changed almost completely in a manner perhaps unsurpassed in legal history. Many types of conduct that were almost certainly illegal in 1975 were almost certainly legal in 2010 and remain so today.[89] Antitrust courts' reaction to the laissez-faire total welfare approach varied, but they readily adopted an economic approach, applying theory and empirical evidence in a fact-intensive analysis of the cases at hand.

For analysis of exclusionary conduct under section 2, this transformation began in 1975 in the Tenth Circuit case, *Telex Corp. v. IBM*.[90] In that case, Telex accused IBM of engaging in predatory conduct by, among other things, examining its competitors' pricing and strategies, and adjusting its own pricing and strategies accordingly.[91] Analyzing these allegations and applying its understanding of antitrust law and economics, the Tenth Circuit rejected the notion that *Alcoa*'s "thrust upon" language meant a monopolist's allegedly predatory conduct must be "entirely involuntary."[92] The court recognized that this conception would entrench a firm in a state of stasis once it acquired monopoly power, essentially prohibiting the firm from further competing—and that such stasis is, itself, antithetical to antitrust's goals of enhancing the competitive process.[93]

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[88] For a critical view, see Frederick M. Rowe, *The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics*, 72 GEO. L.J. 1511, 1513, 1569–70 (1984).

[89] *See, e.g.*, William E. Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix*, 2007 COLUM. BUS. L. REV. 1, 3–5.

[90] 510 F.2d 894 (10th Cir. 1975). Arguably, the first signs of an antitrust shift came in a merger case, *United States v. General Dynamics Corp.*, decided the year before. 415 U.S. 486, 511 (1974). But *Telex* was the first case to seriously revisit the concept of exclusionary conduct under section 2.

[91] *Telex*, 510 F.2d at 900–02.

[92] *Id.* at 927.

[93] *Id.* at 927–28.

The Supreme Court and the courts of appeals subsequently, and similarly, began applying the Chicago and Harvard approaches and, accordingly, narrowing antitrust law's scope in other areas, including with respect to competitor suits[94] and vertical distribution restrictions.[95] In recrafting the antitrust rules, the courts were heavily influenced by the economic approach to antitrust generally and to section 2 particularly. In *Berkey Photo, Inc. v. Eastman Kodak Co.*,[96] for example, the Second Circuit explained the "rightful" meaning of *Alcoa*'s statement that section 2 prohibits even well-behaved monopolies was that "if monopoly power has been acquired or maintained through improper means, the fact that the power has not been used to extract improper benefits provides no succor to the monopolist."[97] Indeed, as scholars had urged was necessary, the *Berkey* Court distinguished between a firm's procompetitively exercising the benefits of its size, such as by taking advantage of scale economies, and its abusing its size to the detriment of consumers, by, for instance, engaging in actions that "are possible or effective only if taken by a firm that dominates its smaller rivals."[98]

Similarly, in *California Computer Products v. IBM*,[99] the Ninth Circuit recognized that, "[w]here the opportunity exists to increase or protect market share profitably by offering equivalent or superior performance at a lower price, even a virtual monopolist may do so."[100] These cases essentially eschewed the aspects of *Alcoa* that would condemn the successful competitor for having succeeded. In doing so, they began to recognize that

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[94] *See* Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977) (holding an antitrust competitor plaintiff "must prove *antitrust* injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes the defendants' acts unlawful" (emphasis added)).

[95] *See* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 56–59 (1977); Richard Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282, 283, 287–88 (1975) (holding a manufacturer's imposition of exclusive geographic distribution restrictions upon its retailers was not per se unlawful, but should be evaluated under the rule of reason).

[96] 603 F.2d 263 (2d Cir. 1979).

[97] *Id.* at 274.

[98] *Id.* at 274–75.

[99] 613 F.2d 727 (9th Cir. 1979).

[100] *Id.* at 742.

protecting competition is not an end unto itself, but merely a means for preserving and enhancing consumer welfare and the competitive process.

Continuing in this vein, the courts largely adopted variants of Areeda and Turner's approach to predatory pricing. The courts acknowledged an especially stringent test should apply in cases where the proffered anticompetitive conduct related to price reductions, in order to avoid chilling price competition.[101] The Supreme Court in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*,[102] for instance, explained that predatory pricing schemes are unlikely to be attempted due to their high likelihood of failure. The alleged predator must: (1) forgo immediately available profits; (2) successfully drive competitors out; and (3) successfully keep competitors out long enough to recoup its losses.[103] In other words, predatory pricing requires a predator to engage in a risky, unprofitable course of action, with the hope of not only attaining but also of maintaining monopoly power at some later date when it is charging supracompetitive prices—often no mean feat, given such high prices inevitably entice competitors to enter the market and share in the profits. Moreover, as the Court noted, "cutting prices in order to increase business often is the very essence of competition. Thus, mistaken inferences in cases such as this one are especially costly, because they chill the very conduct the antitrust laws are designed to protect."[104] The Supreme Court reiterated this sentiment in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*,[105] remarking that it "would be ironic indeed if the standards for predatory pricing liability were so low that antitrust suits themselves became a tool for keeping prices high."[106]

While embracing many of the Chicago School's proffered approaches, the courts nonetheless rejected some of the more extreme Chicago positions. For instance, the Supreme Court

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[101] While there is relative consensus today that an antitrust defendant's prices must be below some measure of cost before a section 2 violation can arise, there remains significant dispute as to how to measure costs and the circumstances under which predatory pricing may—or has—occurred. *See generally* Symposium, *100 Years of* Standard Oil *Antitrust*, 85 S. CAL. L. REV. 429 (2012).

[102] 475 U.S. 574 (1986).

[103] *Id.* at 588–91.

[104] *Id.* at 594.

[105] 509 U.S. 209 (1993).

[106] *Id.* at 226–27.

declined to adopt a per se rule denying competitor-plaintiffs standing to challenge acquisitions on the basis of predatory pricing theories—which many Chicagoans supported—reasoning that it "would be novel indeed for a court to deny standing to a party seeking an injunction against threatened injury merely because such injuries rarely occur."[107] Similarly, the Court refused to hold vertical restraints to be per se lawful, though it did generally acknowledge such arrangements are often associated with procompetitive efficiencies.[108]

IV. POST-CHICAGO

The general laissez-faire approach of the Chicago School prevailed in some arenas for a number of years, but by the early 1990s, it started to become supplanted, at least in academia, by what has been called the "Post-Chicago" approach. For section 2 purposes, one key insight of this approach was the concept of "raising rivals' costs"[109] ("RRC"). This concept focuses upon a

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[107] Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 121–22 (1986).

[108] *See, e.g.*, Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 762–63 (1984) (holding vertical agreements between manufacturers and distributors may violate the antitrust laws, but recognizing manufacturers and distributors have many "legitimate reasons" for coordinating along various dimensions, such as the manufacturer's desire to ensure that outside competitors are not "free-riding" off the investments its distributors are making into marketing, hiring, and training knowledgeable employees, and so forth).

[109] *See* Thomas Krattenmaker & Stephen C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs To Achieve Power over Price*, 96 YALE L.J. 209, 214 (1986); Steven C. Salop & David T. Scheffman, *Cost-Raising Strategies*, 36 J. INDUS. ECON. 19, 19–20 (1987); Stephen C. Salop & David T. Scheffman, *Raising Rivals' Costs*, 73 AM. ECON. REV. 267, 267 (1983) [hereinafter *Raising Rivals' Costs*]. While the raising rivals' costs framework is generally considered the "quintessential example of the difference between Chicago School and Post-Chicago School antitrust economics," many scholars have argued that the Chicago school in fact anticipated and accounted for these strategies. Kobayashi & Muris, *supra* note 54, at 161; *see, e.g.*, Steven C. Salop, *Economic Analysis of Exclusionary Vertical Conduct: Where Chicago Has Overshot the Mark*, *in* HOW CHICAGO OVERSHOT THE MARK 141, 145 (Robert Pitofsky ed., 2008) ("[I]t is important to recognize that [Post-Chicago RRC theory] has its roots in the economic analysis of Chicago School commentators."); Herbert Hovenkamp, *Exclusion and the Sherman Act*, 72 U. CHI. L. REV. 147, 158–59 (2005) (describing raising rivals' costs as one of the "foundations of the so-called post-Chicago revolution"). *But see* Kobayashi & Muris, *supra* note 54, at 159, 161 (suggesting "the contributions of the Post-Chicago school to antitrust doctrine and policy are limited," and arguing the Chicago school "did *not* ignore RRC"); Joshua D. Wright, *Moving Beyond Naive Foreclosure Analysis*, 19 GEO. MASON L. REV. 1163, 1163 n.3 (2012) ("The roots of the modern RRC theory were anticipated by Aaron Director and Edward H. Levi.").

competitor's ability to diminish competition, not by offering a better product in any sense of the word, but by increasing operating expenses for its rivals.[110] Early advocates of this framework focused upon two legitimate theories of RRC: (1) foreclosing supply, and (2) inducing collusion.[111] The first theory relates to a predator's acquisition of an exclusionary right—such as an exclusive dealing contract—over a portion of supply such that competitors are foreclosed from achieving minimum efficient scale—that is, the scale necessary to remain competitively effective.[112] The second acknowledges that exclusionary vertical restraints may, under certain conditions, facilitate pricing coordination that benefits the colluding suppliers while raising costs to the purchaser's non-colluding competitors.[113] Under RRC theory, the dominant firm need neither to set unprofitable prices for itself in the first time period nor to recoup these losses in any subsequent period.[114] Thus, from the outset, the RRC framework posits a view of exclusionary conduct that is both profitable for the dominant firm and harmful to consumers.[115] It also considers that such conduct may occur along numerous, non-price dimensions, such as by foreclosing rivals from access to inputs or customers.[116]

The insight underlying the RRC approach was that, if conduct by a dominant firm impaired rivals' abilities to compete to such an extent that the rivals could no longer constrain the defendant's market power, that lack of constraint constituted a potentially serious problem.[117] The result would be increased prices to consumers, diminished innovation, lower quality, fewer services, and so forth.[118] Post-Chicago analysis, similar to Chicago analysis, thus recognizes the value of competitors—but only to the extent that the competitors protect consumers.

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[110] Salop & Scheffman, *supra* note 109.

[111] Krattenmaker & Salop, *supra* note 109, at 236–42.

[112] *Id.* at 236–38.

[113] *Id.* at 238.

[114] *Raising Rivals' Costs*, *supra* note 109, at 267.

[115] *Id.* at 268, 270.

[116] Krattenmaker & Salop, *supra* note 109, at 224.

[117] *Id.*

[118] *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES 2 (2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.html; *see also* Daniel Rockower, *Antitrust Implications of the Comcast-Time Warner Cable Merger*, COLUM. BUS. L. REV. (Apr. 11, 2014, 4:04 PM), *available at* http://cblr.columbia.edu/archives/13011.

Today, the general consensus seems to be that the RRC framework is more useful for evaluating most forms of exclusionary conduct than the predation framework.[119]

The courts have likewise recognized the value of viewing cases through the post-Chicago lens. In 1992, the Supreme Court recognized the importance of information costs in upholding a plaintiff's unlawful tying claim in *Eastman Kodak Co. v. Image Technical Services, Inc.*[120] Since then, economic foreclosure, as developed by post-Chicago analysts, has become a focal point in many cases. For instance, in *United States v. Microsoft Corp.*,[121] the D.C. Circuit evaluated allegations that Microsoft's exclusive dealing contracts with computer manufacturers and Internet access providers ("IAPs") foreclosed competitor web browsers from efficient access to consumers.[122] Under these exclusive contracts, computer manufacturers were not permitted to remove Microsoft's Internet Explorer icon from their computers' desktops, and IAPs, such as AOL, were not permitted to promote non-Microsoft browsers or to supply more than fifteen percent of their subscribers with such browsers.[123] Because computer manufacturers and IAPs were the most cost-effective channels by which browsers could reach consumers, and because Microsoft had such exclusive contracts with fourteen of the fifteen largest IAPs, the court held Microsoft had unlawfully exploited its monopoly power to foreclose its rivals and to prevent them from challenging its monopolistic advantage.[124]

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[119] *See* Christopher R. Leslie, *Rationality Analysis in Antitrust*, 158 U. PA. L. REV. 261, 288 n.147, 339 n.418 (2010) (citing cases criticizing predation issues); Wright, *supra* note 109, at 1163. The major exceptions are predatory pricing and refusals to deal. *See also infra* text accompanying notes 195, 200.

[120] 504 U.S. 451, 486 (1992).

[121] 253 F.3d 34 (D.C. Cir. 2001).

[122] *Id.* at 45.

[123] *Id.* at 60–61, 68.

[124] *Id.* at 64 ("[W]e hold that . . . all the OEM license restrictions at issue represent uses of Microsoft's market power to protect its monopoly . . . ."); *id.* at 71 ("By ensuring that the 'majority' of all IAP subscribers are offered [Internet Explorer] either as the default browser or as the only browser, Microsoft's deals with the IAPs clearly have a significant effect in preserving its monopoly; they help keep usage of Navigator below the critical level necessary for Navigator or any other rival to pose a real threat to Microsoft's monopoly.").

V. WHERE ARE WE TODAY?

While much of the fall-out from the antitrust overhaul beginning in the 1970s has settled, and antitrust today is comparatively more stable, several significant questions remain regarding how antitrust courts, scholars, and lawyers can and should analyze various allegedly anticompetitive conducts. Many of these concerns have become especially pronounced as the economy shifts to rely increasingly upon high-technology industries, whose markets and behaviors are dynamic and often novel. The desire for antitrust to provide clearer rules and guidelines grows commensurately with these market changes and concerns, but such clarity has yet to come to fruition.

It is certain, however, that the tradition of outright hostility to firms with monopoly power eroded with *Brooke Group* and *Matsushita*, and was fully shed by the Supreme Court in its 2004 decision of *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*.[125] In *Trinko*, the Court held that the "mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system."[126] That Court went on to explain that the "opportunity to charge monopoly prices—at least for a short period—is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth."[127] Indeed, the Court not only refrained from displaying hostility towards monopolies generally, but, in fact, condoned them to the extent their benefits incentivize firms to offer enhanced products and to endeavor to satisfy unmet consumer needs.[128] *Trinko*, moreover, cautioned that courts should be wary of erroneously condemning allegedly exclusionary conduct, noting that "[m]istaken inferences and the resulting false condemnations 'are especially costly, because they chill the

[125] 540 U.S. 398, 415–16 (2004).

[126] *Id.* at 407.

[127] *Id.*

[128] In subsequent cases, the Court has continued to recognize this value deriving from monopoly rewards. *See, e.g.*, Pac. Bell Tel. v. Linkline Commc'ns, Inc., 555 U.S. 438, 454–55 (2009).

very conduct the antitrust laws are designed to protect.' The cost of false positives counsels against undue expansion of § 2 liability."[129]

The courts have also recognized that analysis of whether conduct harms the competitive process cannot be based solely on the defendant's conduct. The analysis must also include an inquiry into the complainant's ability to overcome the challenged practice through countermeasures of its own. When doing so is not unduly difficult, the effect of the challenged practice may well be to enhance competition.[130]

While these recognitions are insightful and offer some guidance, we are far from complete cohesion in exclusionary conduct analysis. Many seemingly pre-antitrust revolution claims have survived. For instance, in *West Penn Allegheny Health System v. UPMC*,[131] the appellate court sustained a claim that a vertical agreement harmed competition by providing the defendant with more favorable treatment, causing the plaintiff to receive less advantageous reimbursement rates,[132] and that purportedly false statements about the plaintiff caused it "to pay artificially inflated financing costs" on debt held by sophisticated Wall Street investors.[133] Other courts have cited *Alcoa* as stating the basic rule for monopolization, appearing even to rely upon *Alcoa*'s conception that "no monopolist monopolizes unconscious of what he is doing."[134]

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[129] 540 U.S. at 414 (quoting Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986)); *see also Linkline*, 555 U.S. at 451 (also quoting *Matsushita*, 475 U.S. at 594); NYNEX Corp. v. Discon, Inc., 525 U.S. 128, 136–37 (1998); Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 728 (1998); Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 456, 458 (1993) ("[T]his Court and other courts have been careful to avoid constructions of § 2 which might chill competition, rather than foster it."); *Matsushita*, 475 U.S. at 594 (noting that incorrect incorrectly identifying conduct as predatory pricing is "especially costly because [it] chill[s] the very conduct the antitrust laws are designed to protect").

[130] *See, e.g.*, NicSand, Inc. v. 3M Co., 507 F.3d 442, 452, 455 (6th Cir. 2007).

[131] 627 F.3d 85 (3d Cir. 2010).

[132] *Id.* at 105. *But see* Monahan's Marine v. Bos. Whaler, Inc., 866 F.2d 525, 527 (1st Cir. 1989).

[133] *W. Penn Allegheny Health Sys.*, 627 F.3d at 110. *But see* Sanderson v. Culligan Int'l Co., 415 F.3d 620, 623–24 (7th Cir. 2005).

[134] LePage's Inc. v. 3M, 324 F.3d 141, 150 (3d Cir. 2003) (internal quotation marks omitted). Some recent agency cases, such as the FTC's case against McWane, Inc., currently on appeal to the Eleventh Circuit, No. 14-11363, have likewise been criticized for employing pre-revolution theory and analysis. *See* Opinion of the Commission, McWane, Inc., Docket No. 9351 (F.T.C. Feb. 6, 2014), *available at* http://www.ftc.gov/system/files/documents/cases/140206mcwaneopinion_0.pdf;

The cases today, accordingly, provide no consistent, thorough approach for evaluating allegedly exclusionary conduct. Although the beginnings of rules have started to emerge for specific types of conduct, not even these rules are yet clear, aside from the below-cost pricing rule for predatory pricing. The antitrust agencies have been concerned enough with this opaque state of play to hold hearings in both 2006 and 2014 surrounding the issue of how antitrust should approach various allegedly exclusionary behaviors.[135] Following the agencies' 2006 to 2007 hearings, the U.S. Department of Justice issued its "Section 2 Report,"[136] which sought "to make progress toward the goal of developing sound, clear, objective, effective and administrable standards for Section 2 analysis."[137] While this Report was intended to clarify the agencies' approach to section 2, it was quite controversial—with the Federal Trade Commission refusing to join—and was withdrawn just a few months after being issued.[138] One important reason for its ultimate revocation is that, according to many, the Report attempted to over-simplify section 2 enforcement by fitting most, if not all, allegedly exclusionary conduct into a variant of the *Brooke Group* price-cost framework.[139] But exclusionary conduct can manifest

Dissenting Statement of Commissioner Joshua D. Wright, McWane, Inc., Docket No. 9351 (F.T.C. Feb. 6, 2014), *available at* http://www.ftc.gov/system/files/documents/public_statements/202211/140206mcwanestatement.pdf. Others have vigorously defended the result. *See* Steven C. Salop, *Economic and Legal Analysis of Exclusive Dealing by Monopolists: A Decision-Theoretic Approach* (forthcoming 2015).

[135] Press Release, Fed. Trade Comm'n, FTC DOJ Seek Comments for Upcoming Hearings on Single-Firm Conduct (Mar. 30, 2006), *available at* http://www.ftc.gov/news-events/press-releases/2006/03/ftc-doj-seek-comments-upcoming-hearings-single-firm-conduct; *Conditional Pricing Practices: Economic Analysis and Legal Policy Implications: An FTC-DOJ Workshop* (June 23, 2014), http://www.ftc.gov/news-events/events-calendar/2014/06/conditional-pricing-practices-economic-analysis-legal-policy.

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

[137] Press Release, U.S. Dep't of Justice, Justice Department Issues Report on Antitrust Monopoly Law 1–2 (Sept. 8, 2008), *available at* http://www.justice.gov/atr/public/press_releases/2008/236975.pdf.

[138] Press Release, U.S. Dep't of Justice, Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009), *available at* http://www.justice.gov/atr/public/press_releases/2009/245710.htm.

[139] *See, e.g.*, *id.*; Fed. Trade Comm'n, Statement of Commissioners Harbour, Leibowitz & Rosch on the Issuance of the Section 2 Report by the Department of Justice (Sept. 8, 2008), *available at* http://www.ftc.gov/sites/default/files/

in many ways that are not properly captured by a price-cost test. The Report thus left many unsatisfied and ill at ease—and left open the question of what rule or rules to apply in exclusionary conduct cases.

With unclear, and at times conflicting, guidance and opinions seeming to abound, the question then arises of what is an exclusionary conduct defendant or plaintiff to do?

VI. EMERGENCE OF A FLEXIBLE EQUALLY EFFICIENT RIVAL APPROACH

It is widely recognized that distinguishing pro and anticompetitive conduct is a fundamental and significant hurdle for antitrust factfinders, and, as discussed, exclusionary conduct has proven to be a particularly thorny arena.[140] It is equally well recognized that efforts to find a one-size-fits-all standard for all aspects of exclusionary conduct have failed, and that different types of conduct require their own assessments.[141]

To assist in the tricky endeavor of identifying the conduct that crosses the line, antitrust law often seeks to create screens for ascertaining at an early stage whether particular conduct poses a serious risk of harming consumers.[142] Several factors must be taken into account in designing any such screen, including: (1) what economic theory instructs may be the particular adverse consequences arising the type of conduct in issue; (2) what empirical evidence suggests regarding how often the conduct will yield undesirable outcomes; and (3) the capacity of the fact finder—be it an agency, a judge, or a jury—to understand and properly distinguish between procompetitive and anticompetitive conduct. Bearing these considerations in mind, a useful way to evaluate many forms of allegedly exclusionary conduct, especially given current economic understanding, is to determine whether the conduct passes a flexible equally efficient rival screen. The question posed is whether a hypothetical rival, facing the same incremental costs as the defendant, can

attachments/press-releases/ftc-commissioners-react-department-justice-report-competition-monopoly-single-firm-conduct-under/080908section2stmt.pdf.

140 *See supra* Part V.

141 *See, e.g.*, Mark S. Popofsky, *Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules*, 73 ANTITRUST L.J. 435, 437 (2006).

142 This is exemplified, perhaps most prominently, in the below-cost pricing requirement for predatory pricing.

profitably meet or better the defendant's sales offer; if so, that offer should not be deemed exclusionary. This screen thus changes the focus of the analysis from one directed solely at the conduct of the defendant to one that also considers the real effect on the plaintiff—to determine whether there is true exclusion or whether the conduct is better characterized as creating an incentive for the plaintiff to dig down and compete more effectively.

As a threshold matter, it is important to note that this equally efficient rival analysis provides an effective safe harbor, not a test of illegality. Prices or other offers that could not be met on this basis would not necessarily be unlawful; rather, further analysis would be required to discern whether the effect of the conduct would increase, protect, or maintain the defendant's market power. But conduct that an efficient rival could counter effectively would be deemed not exclusionary or otherwise unlawful. The test should, in other words, rule out the possibility that exclusion is occurring based upon the competitive merits. In doing so, the test seeks to ensure that rivals have an equal opportunity to compete for the business in issue. Competition at this stage is often a significant driver of consumer benefits, and preserving competition for the contract is, accordingly, a high priority in antitrust law.[143] The equally efficient rival approach is designed to balance the desire to avoid punishing competitively beneficial conduct against the need to prevent firms from employing facially beneficial practices to maintain or otherwise exploit their monopoly power. Simultaneously, as developed below, this test remains relatively administrable while being nuanced enough to respond to differing economic considerations in various types of, but not all, exclusion cases.

The equally efficient rival test, moreover, finds considerable support in both academia and case law. Prominent antitrust scholars have endorsed the equally efficient rival test. Judge Posner, for example, contends that a monopolist's conduct should be deemed exclusionary if "the challenged practice is likely in the

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[143] The seminal case on this point is Judge Easterbrook's opinion in *Paddock Publications v. Chicago Tribune Co.*, 103 F.3d 42 (7th Cir. 1996). On the economic origins, see Harold Demsetz, *Why Regulate Utilities*, 11 J.L. & ECON. 55 (1968); Oliver E. Williamson, *Franchise Bidding for Natural Monopolies—in General and with Respect to CATV*, 7 BELL J. ECON. 73 (1976).

circumstances to exclude from the defendant's market an equally or more efficient competitor."[144] Areeda and Hovenkamp similarly support this approach, arguing that "[a]ctionable exclusion requires a showing not merely that a particular rival cannot compete effectively, but that no equally efficient rival can."[145] Some courts have likewise acknowledged the utility of the equally efficient rival approach. The Ninth Circuit, for instance, has adopted a test for bundled discounting cases that "ensures that the only bundled discounts condemned as exclusionary are those that would exclude an equally efficient producer of the competitive product or products."[146] The European Commission has also endorsed this test, noting that "the Commission will normally only intervene where the conduct concerned has already been or is capable of hampering competition from competitors which are considered to be as efficient as the dominant undertaking."[147]

It is unsurprising that the equally efficient rival test has experienced a certain level of success. In recent years, antitrust law has shifted to focus much more heavily upon the competitive effects of allegedly anticompetitive conduct, as opposed to indirect methods of inferring that certain conduct is or is not anticompetitive,[148] and the equally efficient rival test functionally

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144 POSNER, *supra* note 76, at 194–95.

145 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 749a (3d ed. 2008).

146 Cascade Health Solutions v. Peacehealth, 515 F.3d 883, 909 (9th Cir. 2008); *see also* Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc., 920 F. Supp. 455, 467 (S.D.N.Y. 1996) ("The question, therefore, is whether a firm that enjoys a monopoly on one or more of a group of complementary products, but which faces competition on others, can price all of its products above average variable cost and yet still drive an equally efficient competitor out of the market. The answer to this question seems to be that it can . . . ."); *infra* Part VII.B (providing a fuller discussion of this case). *But see* Analysis of Proposed Consent Order to Aid Public Comment, at 10, *In re Intel Corp.*, Docket No. 9341 (FTC File No. 061 0247) (Aug. 4, 2010), *available at* http://www.ftc.gov/sites/default/files/documents/cases/2010/08/100804intelanal_0.pdf (the Commission expressly noted the proposed consent did "not reflect an endorsement or adoption" of an equally efficient rival test like that espoused in *Peacehealth*).

147 Communication from the Commission—Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings February 2009, art. 2, 2009 O.J. (C 45) 7, 11, *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52009XC0224(01)&from=EN [hereinafter *EC Guidance Paper*].

148 *See, e.g.*, U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 4 (2010), *available at* http://www.ftc.gov/sites/default/

hones in on what the excluded rival can and should do to compete. It is advantageous in that it is not an exclusively price-cost based, or "*Brooke Group,*" approach; such approaches often distract from the actual competitive effects analysis by focusing, somewhat myopically, upon whether the conduct entails lost profits that are likely later to be recouped—a focus inapt for the many varieties of conduct that are both immediately profitable and exclusionary.[149] That is, price-cost based tests are more adept at analyzing conduct that involves a short-term sacrifice of profitability with an expectation that the profits will be recovered once rival competition has been removed. They are much less appropriate in evaluating methods of exclusion that rely on methods of foreclosure that are also profitable in the short term.

The equally efficient rival approach has a fundamentally closer nexus with the RRC framework. This approach asks whether, notwithstanding the defendant's conduct, rivals of equal efficiency could implement counterstrategies allowing them profitably to compete for the business; that is, whether by doing so rivals could achieve minimum efficient scale, which is the concern inherent in the RRC framework.[150] If such competition would not be profitable, the focus then shifts to discerning why it is not. At this stage, this approach allows the fact finder to examine whether it is the defendant's superior efficiency or something else—possibly something malevolent[151]—that, in practice, renders competition infeasible. Antitrust law endeavors to proscribe conduct by a monopolist that prevents competitors from disciplining its monopoly power, and the equally efficient rival test seeks to ascertain whether such prevention is in fact occurring by identifying in the first instance where it can be said that is clearly not. In doing so, the test acknowledges and attempts to account for the types of harms RRC theories proffer.

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files/attachments/merger-review/100819hmg.pdf ("The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects.").

[149] *See, e.g.*, Jonathan M. Jacobson & Scott A. Sher, *"No Economic Sense" Makes No Sense for Exclusive Dealing*, 73 ANTITRUST L.J. 779, 780–81 (2006).

[150] *See* Joanna Warren, LePage's v. 3M: *An Antitrust Analysis of Loyalty Rebates*, 79 N.Y.U. L. REV. 1605, 1622 (2004).

[151] *See* Telex Corp. v. Int'l Bus. Machs. Corp., 510 F.2d 894, 927 (10th Cir. 1975) ("The term ['predatory'] probably does not have a well-defined meaning in the context it was used, but it certainly bears a sinister connotation.").

While the equally efficient rival test offers numerous benefits, it is far from perfect. Less efficient rivals can often compete and generate lower prices or higher output for consumers.[152] By injecting even a modicum of more competition into the market, less efficient competitors may be able to make consumers somewhat better off.[153] Against this potential benefit, however, the cost to businesses of increased antitrust exposure and uncertainty must be weighed. Is the plaintiff really constrained from competing, or is its failure just a product of its less efficient cost structure or, worse, a desire to maintain high profit margins? Businesses need some standard by which to judge what they can and cannot do. Without any concrete standard, antitrust can pose unwarranted risks of chilling significant amounts of procompetitive conduct. Businesses are likely to stay far afield from conduct that puts them at risk for treble damages and follow-on lawsuits, refusing to engage even in procompetitive conduct that might put it at risk, and the potential increase in competition deriving from the continued existence of a less efficient rival may very well be overwhelmed by the diminished competition along other dimensions. Especially when the allegedly harmful conduct involves discounting or implicates a firm's ability to compete for all or part of a contract, antitrust law must tread carefully. A blunt approach in these areas threatens to dampen competition in the long run and to raise prices to consumers even more than the supposedly anticompetitive conduct.

At the same time, flexibility and common sense are necessary.[154] Analysis of the rival's effectiveness need not be based upon pure price-cost determinations but, rather, should be flexible enough to conform to the facts of the case at hand. Where a new entrant, for example, may not be equally efficient today but is likely to become as efficient in the reasonably foreseeable future, exclusion of the entrant is likely to harm

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[152] *EC Guidance Paper*, *supra* note 147, ¶ 24; Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 ANTITRUST L.J. 311, 328 (2006).

[153] *See* Jennifer E. Sturiale, *Compulsory Licensing of Intellectual Property as Merger Remedy: A Decision-Theoretic Approach*, 72 LA. L. REV. 605, 610 (2012).

[154] This flexibility extends both to the initial, screening application of the equally efficient rival approach, and to subsequent conduct-specific analysis under the full rule of reason for those cases that fail the first screen.

consumers.[155] The focus on the entrant's ability to compete, therefore, should be forward-looking and take into consideration the entrant's likely efficiency, in the absence of exclusion, over the next few years.[156] Similarly, where costs are relevant, the analysis needs to account for those types of products, such as drugs or software, where incremental costs are very low but where upfront investments may be quite high; this disparity in cost allocation could theoretically allow a firm to price above incremental cost but well below the cost at which an equally efficient rival could effectively compete, due, for instance, to the rival's more recent entry and need to cover a greater portion of its upfront costs in its sales price.

This flexibility, while essential to protect the competitive process, necessarily injects some additional uncertainty into the analysis. Still, application of this kind of flexible equally efficient rival analysis should allow firms to plan and compete effectively. The ultimate focus is whether the rival could, if it elected to compete effectively, take steps to gain the business—or sufficient business—in issue. If the rival can cut its prices or otherwise defeat the threatened foreclosure, the conduct should not be unlawful. If it cannot do so because of an inefficient cost structure or other factors for which the defendant is not responsible, it similarly should have no claim. But if the practice in question would prevent an equally efficient rival from competing effectively to constrain the defendant's market, and is not offset by sufficient consumer benefits, the rival's case should be allowed to proceed. Dominant firms and their counsel should be able to analyze these factors well enough to separate the safe from the unduly dangerous.[157] The essence of the antitrust point

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[155] *See* Krattenmaker & Salop, *supra* note 109, at 269; Thomas A. Piraino, *An Antitrust Remedy for Monopoly Leveraging by Electronic Networks*, 93 NW. U. L. REV. 1, 32–33 (1999).

[156] *See* Einer Elhauge, *Why Above-Cost Price Cuts To Drive Out Entrants Are Not Predatory—and the Implications for Defining Costs and Marked Power*, 112 YALE L.J. 681, 755 (2003).

[157] Justice Brandeis's famous observation is apt:

> I have been asked many times as regard to particular practices or agreements as to whether they were legal or illegal under the Sherman [antitrust] law. One gentleman said to me: 'We do not know where we can go.' To which I replied: 'I think your lawyers . . . can tell you where a fairly safe course lies. If you are walking along a precipice no human being can tell you how near you can go to that precipice without falling over, because you may stumble on a loose stone, . . . but [the lawyer] can tell you where

is that a plaintiff who can compete should—and a plaintiff that cannot compete effectively due to its own inefficiency, or unwillingness, should not be able to advance a cognizable claim.[158]

VII. APPLICATION IN PRACTICE

This analysis can be applied to many variants of allegedly exclusionary conduct, including exclusive dealing, bundling, loyalty discounts, and tying: but it is not a panacea. The types of practices with exclusionary potential are many and varied, with different effects and with widely varying implications for dominant firm incentives. Efforts to develop an overall test for dominant firm conduct have therefore proven elusive.[159] We set forth here some of the variants of dominant firm conduct that are often challenged to see where—and how—equally efficient rival analysis can be applied, and where it cannot.

A. *Exclusive Dealing*

The equally efficient rival test proves especially beneficial in instances such as exclusive dealing where the allegedly exclusionary conduct only rarely raises legitimate competitive concerns, but where, when present, such concerns can be quite serious.[160] It is well-recognized that numerous procompetitive benefits are associated with most exclusive arrangements—these arrangements often make distribution more effective by increasing dedication and loyalty, minimizing free-riding, improving product quality, and providing customers and

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> you can walk perfectly safe within convenient distance of that precipice.' The difficulty which men have felt . . . has been rather that they wanted to go to the limit rather than that they have wanted to go safely.

Hearings on S. Res. No. 98 Before the Sen. Comm. on Interstate Commerce, 62d Cong. 1161 (1911).

[158] Courts have, indeed, recognized this very point. *See, e.g.*, ZF Meritor, LLC v. Eaton Corp., 696 F.3d 254, 281 (3d Cir. 2012) (recognizing that unlawful foreclosure may occur when competitors are "driven out . . . because they are never given an opportunity to compete, despite their ability to offer products with significant customer demand"); Allied Orthopedic Appliances Inc. v. Tyco Health Care Grp. LP, 592 F.3d 991, 997 (9th Cir. 2010) (holding competitors were not foreclosed "because 'a competing manufacturer need[ed] only offer a better product or a . . . better deal to acquire [a customer's business]' ").

[159] *See* Popofsky, *supra* note 141, at 435–36.

[160] *See, e.g.*, United States v. Dentsply Int'l, Inc., 399 F.3d 181, 187 (3d Cir. 2005).

suppliers with a reliable supply source.[161] Under certain circumstances, however, exclusivity can lock a plaintiff out and raise rivals costs in a manner that enhances the defendant's market power, without commensurate consumer benefits. Distinguishing between these two scenarios is critical, and the flexible equally efficient rival test provides a workable mechanism for doing so.

The screen we would suggest is relatively clear for exclusive dealing: A plaintiff who can either break the exclusivity with an equally attractive offer of its own or otherwise effectively compete for sufficient business such that it continues to constrain the defendant's market power should not be allowed to recover. This screen recognizes that most exclusive dealing cases today are based upon RRC theories, which posit that a defendant may be anti-competitively excluding a rival using non-price foreclosure mechanisms.[162] Indeed, substantial foreclosure is a *necessary* condition in any exclusive dealing case: The plaintiff must demonstrate that it was blocked or impeded from either sufficient volume or a critical input so as to prevent it from meeting minimum efficient scale or otherwise competing effectively, and that this impairment of rivals contributed materially to the defendant's acquisition or maintenance of monopoly power.

A focus solely upon the percentage of the market covered by the arrangements, however, is inappropriate. This is especially true given the ease with which market definitions and foreclosure percentages can be manipulated. Reliance simply on numbers often obscures an analysis of actual competitive effects in favor of a more formalistic reliance upon the percentage of contracts covered by the exclusionary agreements alone, often without any accounting for the competitive realities surrounding

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[161] *See, e.g.*, Alden F. Abbott & Joshua D. Wright, *Antitrust Analysis of Tying Arrangements and Exclusive Dealing*, *in* ANTITRUST LAW AND ECONOMICS 183 (Keith N. Hylton ed., 2010); Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311, 357–60 (2002); Joshua D. Wright, Commissioner, U.S. Fed. Trade Comm'n, Remarks Made at the Bates White 10th Annual Antitrust Conference, Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts (June 3, 2010), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/simple-wrong-or-complex-more-accurate-case-exclusive-dealing-based-approach-evaluating-loyalty/130603bateswhite.pdf.

[162] Indeed, as discussed, a defendant may be pricing above cost but still excluding a competitor to the detriment of competition and consumers. *See* Krattenmaker & Salop, *supra* note 109, at 243.

the agreements, such as what percentage of the volume the defendant would have supplied even absent the exclusive component.[163]

Instead of looking solely to numeric percentages, the focus ought to be upon whether, in fact, the arrangement is such that an efficient rival is so impaired that it can no longer compete effectively. If, for instance, an efficient competitor could offer the same or a better deal than the defendant without enticing any customers away because of the defendant's arrangements, the likelihood the defendant is behaving in an exclusionary fashion is higher.

Courts have recognized and applied this reasoning in two notable recent cases, *NicSand, Inc. v. 3M Co.*[164] and *Eisai Inc. v. Sanofi-Aventis U.S., LLC*.[165] In *NicSand*, the court affirmed a dismissal of NicSand's exclusive dealing claims after concluding NicSand's loss of market share to 3M stemmed from its refusal to engage in the vigorous competition required to satisfy consumers' expectations.[166] Between 1987 and 2001, NicSand and 3M were the only nationwide suppliers of do-it-yourself automotive sandpaper, a market in which six large retail purchasers accounted for eighty percent of the market and in which five of these retailers offered their shelf space on an exclusive basis for one year at a time.[167] At its peak, NicSand commanded a sixty-seven percent market share, but rapidly lost standing to 3M between 1997 and 2001.

After experiencing this loss of prominence, NicSand brought an antitrust suit against 3M. NicSand premised its claims upon three of 3M's competitive strategies: (1) The up-front payments that 3M offered to the four retailers that switched from NicSand

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[163] If, for example, a defendant's exclusive agreements cover eighty percent of a market, but it would have supplied seventy-five percent even if it did not offer an exclusive arrangement, then the effect of the exclusive component is to prevent rivals from accessing that additional five percent of the market; courts, however, would typically calculate the percentage foreclosure in this example as eighty percent without further inquiry. *See* Wright, *supra* note 109, at 1182–83, 1185 (analyzing cases in which courts have misused the "substantial foreclosure" screen and proffering a "but-for foreclosure" measurement that accounts for the volume a defendant would have absent any exclusive arrangement and would more accurately reflect the competitive effects of exclusive agreements at issue).

[164] 507 F.3d 442 (6th Cir. 2007).

[165] No. 08-4168 (MLC), 2014 WL 1343254 (D.N.J. Mar. 28, 2014).

[166] 507 F.3d at 447.

[167] *Id.*

to 3M; (2) the multi-year terms of the agreements between 3M and the retailers; and (3) the exclusive nature of these agreements.[168] The court found each of these grounds meritless. First, the court noted that, even accounting for the up-front payments, NicSand conceded that 3M did not engage in any predatory pricing, and, moreover, that retailers routinely demanded such payments before switching suppliers. Second, the court found 3M merely offered—but did not require—multi-year contracts, and that the retailers were able to insist upon lower prices in exchange for these longer contracts. Indeed, the court observed that "[h]aving previously paid NicSand prices generating 38-49% profits margins, the large retailers cannot be blamed for accepting better prices with 3M for several years, not just one."[169]

Finally, turning to the exclusive nature of the agreements at issue, the court held "NicSand has not claimed—and cannot tenably claim—that it suffered . . . anticompetitive effects" deriving from the exclusive contracts.[170] The court noted, again, that the exclusive nature of the agreements was something the retailers insisted upon, not something 3M forced upon them. The court continued to find that "NicSand offer[ed] no explanation why it could not compete for these multi-year agreements nor why (in view of its high margins) it could not match 3M's discounts."[171] Quite to the contrary, the court found "NicSand had every opportunity to compete and yet it failed to do so."[172] Accordingly, the court dismissed NicSand's claims.

Similarly, in *Eisai*, the court held Eisai's antitrust claims could not withstand an exclusive-dealing analysis because the court believed there was no evidence Eisai was precluded from competing for the contracts.[173] Both Eisai and Sanofi manufactured competing anticoagulant drug products, Fragmin and Lovenox, respectively.[174] Eisai contended Sanofi's loyalty

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[168] *Id.* at 451.

[169] *Id.* at 453.

[170] *Id.* at 454.

[171] *Id.*

[172] *Id.*

[173] Eisai Inc. v. Sanofi-Aventis U.S., LLC, No. 08-4168 (MLC), 2014 WL 1343254, at *31 (D.N.J. Mar. 28, 2014). As a disclaimer, Mr. Jacobson represented Eisai at the motion to dismiss stage of proceedings in this case. Nothing in this paper should be taken as representing the views of Eisai or any party to the case.

[174] *Id.* at *1.

discounts program constituted unlawful exclusionary conduct under an exclusive dealing theory because it was foreclosed from sixty-eight percent to eighty-four percent of the market and because "more hospitals would have switched to Fragmin . . . if not for the Lovenox Program[.]"[175] The court, however, concluded on summary judgment that no unlawful foreclosure occurred, noting that record evidence indicated "Eisai could, and at times did, compete more vigorously to increase its market share," and that, when Eisai did "compete[] more aggressively by offering greater discounts, it won more business."[176] Indeed, the court found both Fragmin's and another competitor's drugs gained market share during the period of allegedly anticompetitive conduct, thereby indicating "that customers could walk away from the Lovenox discounts when they so desired, and they did."[177] Here again, the court focused upon whether the plaintiff could compete, and its holding hinged upon the finding that Eisai could do, and at times did do, just that.

NicSand and *Eisai* provide examples of how the flexible equally efficient rival test can operate in practice. In each case, the court inquired whether the plaintiff was capable of competing for the contracts, analyzing the allegations and the facts to determine, fundamentally, what was being argued and what was actually occurring. The courts determined that, in each instance, the plaintiff proffered no reason why it could not have competed successfully for the contracts in the first instance. The courts

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[175] *Id.* at *32.

[176] *Id.* at *33–34.

[177] *Id.* at *34. Moreover, the court then noted its holding was consistent with the approach taken in other circuits under similar facts. It cited the Ninth Circuit's decision in *Allied Orthopedic Appliances Inc. v. Tyco Health Care Group LP*, 592 F.3d 991, 997 (9th Cir. 2010), for the proposition that competitors are not foreclosed when "a competing manufacturer need[] only offer a better product or a . . . better deal to acquire [a customer's business]"; the Eighth Circuit's *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1059, 1063 (8th Cir. 2000), opinion, finding competitors are not unlawfully excluded when customers are " 'free to walk away' from the discounts and [they] d[o] in fact walk away when competitors offer[] better discounts"; and the Sixth Circuit's *NicSand* opinion and concluded these cases demonstrate "that, in general, antitrust claims fail if customers are able to walk away from the defendant's discounts and still use the defendant as a supplier." *Eisai*, 2014 WL 1343254, at *34–36.

concluded that NicSand and Eisai were both capable of offering more competitive terms but had opted not to and should not be rewarded for refusing to engage in competitive behavior.[178]

B. Bundling

Bundling presents a somewhat easier, at least in principle, application of the equally efficient rival test. Bundling occurs when a discount is conditioned on the buyer's agreement to purchase two or more products from the same seller and is pervasive in the modern economy. While it is often a means of price competition with the corresponding consumer benefits, under a RRC theory, bundling can deprive equally or more efficient single-product rivals of the volume needed to achieve economies of scale. In such circumstances, rivals' ability to constrain the multi-product defendant's market power may be impaired and consumers may be harmed both by the potential reduction of competition in the competitive product market and by the reinforcement of barriers to entry in the monopoly product market.

Courts and scholars have made substantial strides in applying the equally efficient rival test to bundled discounting.[179] Much of this progress followed the heavily criticized opinion in *LePage's, Inc. v. 3M*,[180] which itself referenced the equally efficient rival test, but proceeded, misguidedly, to focus primarily upon harm to competitors rather than harm to consumers.[181] The *LePage's* court held a jury can reasonably conclude that a multi-product firm with monopoly power in a relevant product market

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[178] Other cases have similarly concluded exclusive arrangements were not anticompetitive when the plaintiff had the opportunity and ability to compete for volume. *See, e.g.*, R.J. Reynolds Tobacco Co. v. Philip Morris Inc., 199 F. Supp. 2d 362, 391 (M.D.N.C. 2002) ("Because Retail Leaders agreements are terminable at will with thirty days' notice, retail product and display space are subject to uninterrupted competitive bidding, and Plaintiffs are not substantially foreclosed from the relevant market."), *aff'd,* 67 F. App'x 810 (4th Cir. 2003); *see also* Joshua D. Wright, *Antitrust Law and Competition for Distribution*, 23 YALE J. ON REG. 169 (2006).

[179] *See, e.g.*, Cascade Health Solutions v. PeaceHealth, 515 F.3d 883, 903–04 (9th Cir. 2008); AREEDA & HOVENKAMP, *supra* note 145, ¶ 749a; POSNER, *supra* note 76, at 236; ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS (2007) [hereinafter AMC REPORT], *available at* http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

[180] 324 F.3d 141 (3d Cir. 2003).

[181] *Id.* at 161.

violates the antitrust laws when it bundles that product with another, competitive product in order to expand its share of the competitive product market.[182] This holding essentially premised liability upon the plaintiff's inability to offer as comprehensive a product set, and not upon the ultimate consumer welfare effect and effectively offered no actual test or any limiting principle.[183]

The subsequent discussion and critiques identified the analytical shortcomings of *LePage's* and led to important steps forward, as exemplified in the recommendations of the Antitrust Modernization Commission[184] ("AMC") and in *Cascade Health Solutions v. Peacehealth*.[185] The AMC proffered a three-factored test for assessing bundled discounts: (1) After allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product; (2) the defendant is likely to recoup these short-term losses, either simultaneously or later on; and (3) the bundled discount has had or is likely to have an adverse effect on competition.[186] This test represents an application of the equally efficient rival approach to bundling—it is a screen designed to dispose of those instances in which unlawful exclusionary conduct is *not* occurring by asking whether a rival of equal efficiency could offer the product at the same price. Only a less efficient rival would be negatively impacted by the multi-product firm's bundling if the price of the product remained above cost even after attributing all discounts to that product. And only if a bundle fails this test would the case proceed to analyzing the competitive effects of the bundle.

The Ninth Circuit in *PeaceHealth* employed a similar approach when presented with a bundled discount case. The plaintiff in *PeaceHealth*, McKenzie, offered only primary and secondary hospital care, while the defendant, PeaceHealth, offered primary, secondary, and tertiary care. McKenzie contended PeaceHealth engaged in unlawful bundling by offering insurers additional discounts of up to thirty-five to forty percent

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182 *Id.* at 161–62.

183 *See* Jonathan M. Jacobson, *Exploring the Antitrust Modernization Commission's Proposed Test for Bundled Pricing*, 21 ANTITRUST 23, 24 (2007).

184 AMC REPORT, *supra* note 179.

185 515 F.3d 883, 889 (9th Cir. 2008).

186 *Id.* at 900.

if the insurer made PeaceHealth its only preferred provider for all three levels of care. In analyzing these allegations, the Ninth Circuit declined to follow the Third Circuit's *LePage's* approach, given "the endemic nature of bundled discounts in many spheres of normal economic activity."[187] Likewise, it declined to apply a full *Brooke Group* analysis, which would apply an "aggregate discount" rule and find the bundle unlawful only if the discounted price of the entire bundle were below the bundling firm's incremental cost of producing the entire bundle.[188] In doing so, the court recognized:

> [B]undled discounts present one potential threat to consumer welfare that single product discounts do not: A competitor who produces fewer products than the defendant but produces the competitive product at or below the defendant's cost to produce that product may nevertheless be excluded from the market because the competitor cannot match the discount the defendant offers over its numerous product lines.[189]

Instead, the court held a test based upon the equally efficient rival approach was appropriate:

> [A] plaintiff who challenges a package discount as anticompetitive must prove that, when the full amount of the discounts given by the defendant is allocated to the competitive product or products, the resulting price of the competitive product or products is below the defendant's incremental cost to produce them. This requirement ensures that the only bundled discounts condemned as exclusionary are those that would exclude an equally efficient producer of the competitive product or products.[190]

Accordingly, case law and commentary have demonstrated that an equally efficient rival approach to bundling is both analytically sound, given current economics, and an effective screen in practice. Moreover, this approach strikes a nice balance between the unacceptably vague and overbroad *LePage's* test and the unacceptably narrow full *Brooke Group* variant of per se legality.

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[187] *Id.* at 903.
[188] *Id.* at 904.
[189] *Id.*
[190] *Id.* at 909.

C. Loyalty Discounts

Application of the equally efficient rival test to loyalty discounts, on the other hand, is rather more complex. Loyalty discounts reward consumers for purchasing more from the same supplier; such discounts come in different forms: For example, if a consumer purchases a certain minimum amount of product, he may be rewarded by paying a lower price for each unit going forward or the discount might "revert back" to the first units purchased and the consumer given a "rebate" on those units.[191]

For loyalty discounts, then, attributing all the relevant discounts to the "competitive product" is not literally possible, as the discounts all apply to the same product. Theoretically, the attribution test can be adapted by separating the contestable from the incontestable volumes. While separating these volumes is theoretically possible, and can be modeled nicely when all the simplifying assumptions are made, this exercise is completely impractical and generally unusable in the real world.[192] In *Eisai*, for instance, Eisai's expert argued that Sanofi's loyalty discounts "bundled contestable and incontestable demand for Lovenox."[193] The expert attempted to put numbers to this theory, but, the court determined, the contestable and incontestable volumes did not divide cleanly because the drugs at issue had differing, sometimes unique, FDA-approved indications, and "the incontestable demand relating to these unique indications [wa]s attributable to the inherent properties of the product at issue, and thus competition on the merits."[194]

Rather than becoming entangled in this kind of messy endeavor, loyalty discounts should be properly analyzed like exclusive dealing arrangements; after all, the purpose of loyalty

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[191] *See* Bruce H. Kobayashi, *The Economics of Loyalty Discounts and Antitrust Law in the United States* 1 (George Mason Univ. Sch. of Law, Working Paper No. 40, 2005) (defining loyalty discounts as "a particular form of non-linear pricing in which the unit price of a good declines when the buyer's purchases meet a buyer-specific minimum threshold requirement").

[192] Greg Werden pointed out to us that the test may get things backwards. When the contestable volume is sufficiently low, no material exclusionary effect is possible—and yet the dominant firm's discounts will typically fall outside the safe harbor.

[193] Eisai Inc. v. Sanofi-Aventis U.S., LLC, No. 08-4168 (MLC), 2014 WL 1343254, at *27 (D.N.J. Mar. 28, 2014).

[194] *Id.*

discounts is to induce a certain level of exclusivity.[195] Loyalty discounts offer many of the same efficiencies as exclusive dealing arrangements.[196] Moreover, modern exclusion theories premised upon loyalty discounts, like those based on exclusive dealing, are RRC theories—they hinge upon deprivation of scale and the notion that raising rivals' costs may allow a defendant to create or maintain market power, not on below-cost pricing and recoupment.[197] As with exclusive dealing, rivals and competition may be harmed by preventing a competitor from accessing sufficient volume, even if the defendant is pricing above cost. The equally efficient rival approach, therefore, offers a framework more closely aligned with the economics of the proffered exclusionary theory.

Finally, and perhaps most importantly for our purposes, the fundamental issue in each exclusive dealing and loyalty discount cases is also the same. In both instances, the essential question is whether the plaintiff is able to compete effectively by offering a comparable discount of its own. If the answer is no, then we must ask whether the plaintiff's inability to do so is attributable to a higher cost structure—or to simple unwillingness to offer better terms—in which case its claim should not be permitted.

D. Tying

One of the essential elements in any tying case is that the defendant somehow coerces the consumer into accepting the tied product.[198] There is an application for the equally efficient rival test to tying because, if a rival can break the tie, or otherwise compete effectively for the business, then the defendant's conduct cannot properly be understood as barring competition. If instead,

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[195] *See* Jonathan M. Jacobson, *A Note on Loyalty Discounts*, ANTITRUST SOURCE 1 (June 2010), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Jun10_Jacobson6_24f.authcheckdam.pdf.

[196] *See id.*; Wright, *supra* note 161, at 20–22.

[197] *See* Jacobson, *supra* note 195, at 5 ("In circumstances where loyalty discounts may be harmful, the problem is not the price level; it is that rivals are denied access to customer volume. If the effect is to prevent rivals from constraining the defendant's market power, consumer harm may result. Application of a predatory pricing standard does not accomplish the necessary analysis.").

[198] *See, e.g.*, Borschow Hosp. & Med. Supplies v. Cesar Castillo Inc., 96 F.3d 10, 18 (1st Cir. 1996).

the allegedly unlawful tie is, in fact, a package of products that consumers value, that is competition on the merits, not exclusionary behavior.

E. Refusals To Deal

As discussed, the equally efficient rival approach provides a valuable and reasonably administrable screen for analyzing many types of exclusionary conduct; it is not, however, a test for every monopolization claim. Refusals to deal are a good example of the approach's limitations. If the defendant controls an asset necessary to effective competition, no rival could be equally efficient. Importantly, in a refusal to deal with rivals in the same market—that is, a purely horizontal refusal to deal—antitrust properly places a very high value on incentives to develop one's own product, and, accordingly, such a refusal should only be actionable if it makes economic sense solely by virtue of the exclusion of rivals.[199] In other words, the no economic sense or profit sacrifice test is appropriately applied to cases such as horizontal refusals to deal and price cutting, where the underlying activity is, typically, the very essence of competition and only in the rarest of occasions portends actual competitive harm.[200] Even here, however, some inquiry into the availability of countermeasures is useful. If the desired asset can be

[199] *See* Susan A. Creighton & Jonathan M. Jacobson, *Twenty-Five Years of Access Denials*, 27 ANTITRUST 50, 54 (2012) ("Although we have questioned application of that [no economic sense or profit sacrifice test] in other contexts, when considering activities on which antitrust policy places a particularly high value—such as price cutting or, here, the 'long recognized right of [a] trader . . . freely to exercise his own independent discretion as to parties with whom he will deal'—the test works well."); Jacobson & Sher, *supra* note 149, at 783 n.21 ("[S]imilar to pricing, courts should be reluctant to interfere with a party's decision not to share with rivals assets that it has developed or lawfully acquired. In this context, the no economic sense test works well to determine whether consumers will be harmed—protecting the defendant's incentives to compete and innovate, while condemning refusals to deal where the defendant objectively sacrifices profit in the short term and, in the long term, can recoup that loss after its rivals are marginalized."); Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2: The "No Economic Sense" Test,* 73 ANTITRUST L.J. 413, 414 (2006).

[200] This is true for purely horizontal refusals to deal but not for vertical refusals to deal. Vertical refusals to deal, while framed as "refusal to deal" cases, are, in fact, sufficiently similar to either tying or exclusive dealing, depending upon the specific facts alleged, and are appropriately analyzed as such.

developed by the rival without undue difficulty, or obtained elsewhere on reasonable terms, the plaintiff does not have much of a claim.

F. Product Design

The equally efficient rival test, similarly, cannot be applied to product design challenges. If the plaintiff's product is an input requiring use of a product or service of the defendant, and is impacted by a product design change, analysis of the plaintiff's efficiency is necessarily less relevant. This is a difficult area in which the courts must weigh the very high value the law places on innovation—and the concomitant desire to avoid judicial second-guessing—against the possibility that trivial or illusive design changes may be in fact designed solely to exclude rivals.[201] There seems little room for equally efficient rival analysis in this context.

CONCLUSION

In the cases of an earlier era involving allegations of exclusionary conduct, the focus was solely on the conduct of the defendant. More modern analysis properly looks to the effects on the plaintiff as well. Because the issue is exclusion, and because the fundamental concern in the RRC paradigm is whether a rival can achieve minimum efficient scale, some inquiry into whether the plaintiff can or cannot compete effectively against the tactics in question is essential. Conduct challenged as exclusionary may in fact prevent rivals from constraining the market power of a dominant firm. But the effects of that conduct, almost invariably, are ambiguous: Does the conduct prevent rivals from competing effectively or should it cause rivals to compete more effectively? Distinguishing between these two effects is essential because the one threatens consumer harm while the other yields consumer benefits.

There is no one-size-fits-all test for distinguishing exclusionary conduct from aggressive but legitimate competition. But by placing at least some of the focus on whether an efficient

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[201] *Compare* United States v. Microsoft Corp., 253 F.3d 34, 65–67 (D.C. Cir. 2001), *with* Allied Orthopedic Appliances Inc. v. Tyco Health Care Grp. LP, 592 F.3d 991, 998–1000 (9th Cir. 2010).

rival could meet or defeat the tactics in question, important light is shed on the ultimate question of consumer harm. The law is moving in that direction, and that trend should continue.