EXCLUSIONARY CONDUCT: REFUSALS TO DEAL AND BUNDLING AND LOYALTY DISCOUNTS

Testimony of R. Hewitt Pate

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I. Introduction

Thank you for the opportunity to participate in this afternoon's panel. Because my testimony is rooted in my recent experience with the Antitrust Division, whose enforcement activities and enforcement philosophy are well known, nothing in my testimony should come as a surprise. That experience underscored for me the importance of ensuring that the rules of antitrust law are intelligible and administrable. This is important not only to courts that must apply the law, but also the businesses that must conform their conduct to that law. Accordingly, much of my testimony is devoted to discussing the "no economic sense" test for exclusionary conduct that the Division has articulated and defended in recent years.

My testimony is organized around the four questions identified by the Exclusionary Conduct Study Group. My testimony with respect to the three substantive areas identified by the Study Group–refusals to deal, essential facilities, and bundling discounts–reflects my belief that our common law process for developing antitrust rules through judicial elaboration informed by sound economic theory continues to work reasonably well. I believe this to be so notwithstanding that the process has yet to generate clear rules for evaluating certain types of single-firm conduct, as discussed below. With respect to the fourth and final question–where do we go from here?–I do not believe the Commission should recommend legislative change. Rather, enforcement agencies, courts and private litigants should continue to push the law in the direction of increased objectivity, transparency and administrability.

II. Discussion

A. Refusals to Deal

The Commission's first area of questioning focuses on the appropriate standard for refusals to deal with rivals: When does a refusal to deal with rivals (or discrimination against rivals) violate section 2? Did the Supreme Court state an appropriate standard governing refusals to deal in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004)?[1]

The Department of Justice's *amicus curiae* brief in *Trinko* states what I believe is the correct standard here: "In the context of an alleged refusal to assist a rival, conduct is exclusionary only if it would not make business or economic sense apart from its tendency to reduce or eliminate competition."[2] This "no economic sense" test is one that the Antitrust Division has distilled from the Supreme Court's section 2 case law in an attempt to articulate and defend an objective, transparent, and economically based framework for assessing single-firm conduct. It requires a court to examine whether, on the basis of information available to a firm at the time of the challenged conduct, the challenged conduct would have made economic sense even if it did not reduce or eliminate competition.[3] "[A] refusal to aid rivals that makes economic or business sense apart from a tendency to impair competition is not exclusionary."[4]

[1] 70 Fed. Reg. 28902, 28907 (May 19, 2005).

[2] Brief for the United States at 7, *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), *available at* http://www.usdoj.gov/atr/cases/f201000/201048.pdf (*hereinafter* "DOJ *Trinko* Brief").

[3] For a clear statement and powerful defense of this test by someone whose views often (but not always) shape mine, see Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2: The "No Economic Sense" Test*, ___ Antitrust L.J. ____ (forthcoming).

[4] DOJ *Trinko* Brief at 17.

The "no economic sense" test is consistent with the case law as it has developed up to this point.[5] And this case law has been on the right track, because applying the "no economic sense" test to analyze the propriety of imposing liability for refusals to deal is rooted in sound economic theory. Using this demanding standard in refusal to deal cases "reflects the infrequent pro-competitive benefits and the frequent anticompetitive risks posed by a generalized requirement that firms assist rivals."[6]

Apart from consistency with case law and grounding in sound economic theory, the "no economic sense" test has a crucially important feature that commends its use not only in evaluating refusals to deal, but also in assessing other types of single-firm conduct: The "no economic sense" test can be administered effectively by courts and businesses alike. This test steers courts clear of the pitfalls lurking in application of stricter liability standards that would require greater judicial oversight,[7] and it allows businesses to understand the antitrust consequences of proposed courses of conduct on the basis of information available to them as part of their normal business planning.

I now turn to whether the Supreme Court stated an appropriate legal standard in *Trinko.* The *Trinko* Court did not state an across-the-board standard for assessing refusals to deal.

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[5] *See id.* at 16 (citing *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 608, 610-11 (1985); *General Indus. Corp. v. Hartz Mountain Corp.*, 810 F.2d 795, 803 (8th Cir. 1987); *Stearns Airport Equip. Co. v. FMC Corp.*, 170 F.3d 518, 523-524 & n.3 (5th Cir. 1999); and *Advanced Health-Care Servs. v. Radford Cmty. Hosp.*, 910 F.2d 139, 148 (4th Cir. 1990)).

[6] *Id.* at 17 (explaining that price and output generally remain the same when a monopoly is shared, "dealings among rivals create a risk of collusion," and competition may be forestalled because "[a] firm that has the right to utilize an input from an incumbent . . . may have a reduced financial incentive to develop the input itself").

[7] *See, e.g., AT&T v. Iowa Utils. Bd.*, 525 U.S. 366, 428 (2000) (Breyer, J., concurring in part and dissenting in part) ("Even the simplest kind of compelled sharing . . . means that someone must oversee the terms and conditions of that sharing.").

Trinko's importance lies principally in the skeptical stance it adopted toward the benefits of judicial policing of refusals to deal. The effect of this stance was to sharply limit its "leading case for § 2 liability based on refusal to cooperate with a rival," *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985).[8] I view this limitation of *Aspen* as beneficial, and the underlying normative judgments as correct.

The Court's decision is animated both by a positive evaluation of the important incentive offered by the opportunity to charge monopoly profits and also by a negative evaluation of the capacity of courts to compel a monopolist to share the source of its advantage in a way that would promote consumer welfare. The Court described the possession of monopoly power–and the concomitant ability to charge monopoly prices–as "an important element of the free-market system. . . . [I]t induces risk taking that produces innovation and economic growth."[9] Further emphasizing the importance of incentives to innovate, the Court reasoned that compelling firms who have established an advantage "to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist,

[8] Although I disagree with Prof. Fox's negative evaluation of *Trinko* on the merits, I agree with her assessment that "[t]he fundamental impact of *Trinko* on *Aspen* . . . is not captured by discussing technical rules." Eleanor M. Fox, *Is There Life in* Aspen *After* Trinko*?: The Silent Revolution of Section 2 of the Sherman Act*, ___ Antitrust L.J. ___ (forthcoming). As Prof. Fox explains:

> The fundamental impact is on perspective, which translates into presumptions and burdens, and presumptions and burdens are what really matters in exclusionary practice cases. While in theory *Aspen* is not overruled, *Trinko* has, at least, opened wide the door to argument in every case that the starting point is skepticism about Section 2 and the fear that courts will condemn ambiguous conduct that is in fact efficient.

Id. at ___.

[9] *Trinko*, 540 U.S. at 407.

the rival, or both to invest" in economically beneficial ways.[10] Finally, the Court explained that policing refusals to deal would "requir[e] antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing–a role for which they are ill-suited."[11]

Because dreams of monopoly drive innovation while the availability of forced access to the source of a monopolist's advantage dampens it, and because antitrust courts are bad at "central planning," the Court's opinion in *Trinko* signals that restrictions on "'the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal'" will not lightly be imposed.[12] This is a positive development because it reduces the risk that the threat of judicial intervention will chill pro-competitive conduct, such as capital investment in critical business infrastructure or research and development on innovative products.[13]

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[10] *Id.* at 408.

[11] *Id.*

[12] *Id.* (quoting *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919)).

[13] *See* DOJ *Trinko* Brief, *supra* note 2, at 16 ("[T]his Court has expressed concern that conduct perfectly consistent with robust competition . . . should not lightly give rise to antitrust liability, because doing so may 'chill the very conduct that antitrust laws are designed to protect.'") (quoting *Matsushita Elec. Industrial Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986)); *see also* Competition Committee, Directorate for Financial and Enterprise Affairs, Organisation for Economic Co-operation and Development, *Competition on the Merits – Background Note*, DAF/COMP(2005) 17 (May 9, 2005), at 19 ("If most of the benefit of competition law enforcement comes not from its effect on the companies who are involved in each particular case, but rather from the behavioral influence that those cases have on thousands of other companies, then sacrificing predictability is unwise. Without it, competition policy may unintentionally deter healthy competitive behavior."); *cf.* John Thorne, *Five Freedoms: The Importance of Universal Antitrust Laws*, Address to the Int'l Bar Ass'n (May 23, 2005) (praising a decision of the European Court of Justice for approaching the issue of forced sharing "with humility and wisdom about the institutional ability of courts to find those few instances where the benefits of sharing outweigh the deterrence of investment").

The Court tightly circumscribed *Aspen Skiing*, characterizing it as "at or near the outer boundary of § 2 liability,"[14] and distinguishing the *Trinko* facts on two grounds. First, the defendant in *Aspen Skiing* had terminated a voluntary course of dealing and then "turned down a proposal to sell at its own retail price, suggesting a calculation that its future monopoly price would be higher."[15] In contrast, there was no pre-existing, uncoerced course of dealing between the parties in *Trinko*. Second, "[i]n *Aspen Skiing*, what the defendant refused to provide to its competitor was a product that it already sold at retail," whereas the *Trinko* plaintiff sought access to services that were "not otherwise marketed or available to the public."[16] This aspect of *Trinko* appears to put to rest any claim that a monopolist must make available to would-be competitors what Herbert Hovenkamp has termed "intermediate goods"–*i.e.* goods which are not part of a seller's final product already made available for purchase by others.[17]

[14] *Trinko*, 540 U.S. at 408.

[15] *Id.* at 409. For a negative evaluation of the Court's focus on cessation of a prior course of dealing, *see* Remarks of Mark Whitener, Panel Discussion at 14-15, *Hitting the Section 2 "Refresh" Button for In-House Counsel Following Trinko*, The Antitrust Source (July 2004), *available at* http://www.abanet.org/antitrust/source/July04-Teleconf7=23.pdf (hereinafter "*Trinko* Roundtable"). *See also* Einer Elhauge, *Defining Better Monopolization Standards*, 56 Stan. L. Rev. 253, 314 (2003) (criticizing a test that would limit a duty to deal with rivals to "cases where the monopolist terminated an existing willingness to supply rivals" because "such a limitation would create perverse incentives for a monopolist to refrain from *ever* dealing with a rival . . . out of the fear that this proposed antitrust rule would convert any such dealing into the sort of lifetime tenure normally reserved for professors," and thereby "encourage precisely the sort of discrimination against rivals that is least necessary to further ex ante incentives for investment").

[16] *Trinko*, 540 U.S. at 410.

[17] *See* Remarks of Herbert Hovenkamp, *Trinko* Roundtable, *supra* note 15, at 5 ("[F]or example, if you're in the business of supplying some input for yourself, if you're a natural gas company and you have built a pipeline only to transport your gas for sale to end users, you're not going to be obligated to share that pipeline unless you're in the general business of renting pipeline space.").

Perhaps the most significant aspect of the Court's analysis in *Trinko* is its emphasis on *Aspen Skiing* as a profit-sacrifice case.[18] This emphasis is entirely appropriate,[19] but it is unclear what role the Court envisions for profit-sacrifice considerations.[20] A sacrifice of short-term profits that makes economic sense only because it has the potential to reduce or eliminate competition can be exclusionary. But a sacrifice of short-term profits alone is not necessarily exclusionary. Businesses often surrender short-term profits for investments that promise greater future profits, and they do so for reasons that make business sense independent of any reduction in competition.[21]

Because the Court was able to decide *Trinko* without delving deeply into the proper role of profit-sacrifice considerations, we are left with a decision that is consistent with the "no economic sense" test. While the decision does not explicitly compel the use of this test, it is a

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[18] *See Trinko*, 540 U.S. at 409 ("The unilateral termination of a voluntary (*and thus presumably profitable*) course of dealing suggested a willingness to forsake short-term profits to achieve an anticompetitive end.") (emphasis in original).

[19] *See* DOJ *Trinko* Brief, *supra* n.2, at 19-20 ("In finding sufficient evidence that the Ski Co.'s conduct could 'properly be characterized as exclusionary,' this Court repeatedly stressed that the Ski Co.'s decision to refuse cooperation required the sacrifice of immediate profits.") (*quoting Aspen Skiing*, 472 U.S. at 605); *Aspen Skiing*, 472 U.S. at 510-11 ("[Defendant] was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival").

[20] *See, e.g.,* Fox, *Life in* Aspen, *supra* note 8, at ___ ("Some lower courts are assuming that sacrifice-of-profits is a necessary ingredient of a Section 2 violation, but in this author's view that question is just as open after *Trinko* as before."); *see also* Werden, *"No Economic Sense" Test*, *supra* note 3, at ___ (explaining that, after *Trinko*, "two courts of appeals have suggested that a short-run profit sacrifice may be required to make out a Section 2 violation, although neither asserted that *Trinko* so held," but courts also have "refused to dismiss complaints lacking specific factual allegations of sacrifice").

[21] *See, e.g.,* Werden, *"No Economic Sense" Test*, *supra* note 3, at __ ("A short-term profit sacrifice obviously is insufficient to make conduct exclusionary, because much pro-competitive conduct entails the sacrifice of current profit in the pursuit of greater profit over the longer term."); *see also* Elhauge, *Defining Better Monopolization Standards*, *supra* note 15, at 274-79.

strong step in that direction. Judicial attention to the continually developing body of scholarly literature devoted to understanding the appropriate role of profit-sacrifice considerations,[22] combined with renewed efforts by enforcement authorities to secure adoption of the "no economic sense" test, should continue this positive development.

Having discussed some of the advantages of this test in answering the specific questions posed by the Commission, I should mention some of the more common criticisms leveled against it and explain why I believe it to be better than the consumer welfare effects test often offered as an alternative.[23] As one defender of a version of the "no economic sense" test concedes, the test "does not purport to condemn all conduct that might create market power or reduce economic welfare."[24] But while the test will lead to some false negatives, this criticism has more purchase in the seminar room than in the real world. Because promotion of consumer welfare is the goal of the antitrust laws, the perfect test in theory would of course be one that consistently and accurately condemned *all,* but *only*, that conduct which leads to a net decrease in economic welfare.[25] No such test exists in the real world where businesses must risk capital and make

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[22] *See, e.g.,* Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit Sacrifice Standard*, ___ Antitrust L.J. ___ (forthcoming); Werden, *No Economic Sense Test*, *supra* note 3; John Vickers, *Abuse of Market Power*, 115 ECON. J. F244 (2005); A. Douglas Melamed, *Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal*, 20 Berkeley Tech. L.J. 1247 (2005); Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 Antitrust L.J. 3 (2004); Elhauge, *Defining Better Monopolization Standards, supra* note 15.

[23] Greg Werden has set forth a clear and cogent explanation of why most criticisms of the test are unfounded. *See* Werden, *"No Economic Sense" Test*, *supra* note 3.

[24] Melamed, *Balancing, Sacrifice, and Refusals to Deal*, *supra* note 22, at 1258.

[25] As Prof. Elhauge explains:

> If we lived in a world where information was costless, antitrust judges and juries weighed procompetitive benefits and anticompetitive costs with

(continued…)

practical decisions. Although one can command a judge or jury to consider all relevant circumstances and decide whether the pro-competitive aspects of certain conduct outweigh the anti-competitive aspects of that conduct, this does not mean that the judge or jury can do so accurately.[26] In fact, there is no guarantee that people who do this sort of thing for a living can do so accurately.[27]

Proponents of a consumer welfare effects test respond that such a test "can be implemented without causing excessive false positives that might lead to over-deterrence or a welfare-reducing diminution in innovation incentives."[28] They argue that a consumer welfare

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> perfect accuracy, and firms could predict what judges and juries would do with similarly perfect accuracy, it would be best to have the law on exclusionary conduct simply be that "defendant conduct is illegal only when condemning it enhances social welfare." Indeed, with such omniscience, that could be the law on every topic. . . But the real world is notably different, which is why antitrust law generally prefers to instead rely on a market process.
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> Elhauge, *Defining Better Monopolization Standards*, *supra* note 15, at 330.

[26] *See, e.g.*, Werden, *"No Economic Sense" Test*, *supra* note 3, at __ ("Economic analysis in the courtroom tends to be both incomplete and far from state of the art, and more importantly, [the consumer welfare effects] test generally would be applied by juries that do not understand economics and probably don't care much what it has to say. Reliance on the jury system assures that the consumer welfare test would result in a high incidence of false positive findings of exclusionary conduct.").

[27] *See* Werden, *"No Economic Sense" Test*, *supra* note 3, at __ ("A case that entails both consumer benefits, as from new or better products, and consumer harms, as from higher prices, may overtax the quantitative tools of economics. To be sure, there are ways to estimate all of the consumer welfare effects involved, but they require strong and often untestable assumptions that substantially affect the estimates."); *id.* at __ ("In most cases, the tools of economics provide no satisfactory way to trade off short-run benefits that flow from injecting competition into one market, against long-run costs that flow from the reduced innovation and economic growth which may result from reduced risk taking throughout the economy.").

[28] Salop, *Flawed Profit-Sacrifice Standard*, *supra* note 22, at ___.

effects test does not create uncertainty for businesses because “[t]he consumer welfare effects standard only requires the firm to make a good faith effort to estimate the expected impact of its conduct on consumers.”[29] In other words, the consumer welfare effects test would adopt the ex ante perspective, as the “no economic sense” test does.[30] But it is far from clear how an ex ante viewpoint would properly be maintained in the ordinary course of adjudication under the consumer welfare effects test. It seems significantly more difficult for a factfinder to remain focused on the ex ante world (when a consumer welfare *effects* test would be expected to draw attention to the ex post account of what actually happened), than it would be for the factfinder to adopt the ex ante perspective when examining the business rationale for a decision as of the time of decision (as the “no economic sense” test would require). And even if an ex ante consumer welfare effects test could be implemented properly by an after-the-fact factfinder, how would a business implement the test properly based on information in its possession at the time of decision? The consumer welfare effects test is one that only an academic antitrust expert can love.

While businesses are typically charged with the costs of ensuring that their conduct conforms with the law, this does not mean that costs of compliance should be ignored in determining what the law ought to be. The relative importance of compliance costs in determining the appropriate liability standard can vary depending on the frequency with which those costs would be imposed. It is simply not true that “criticism of the information requirements of the consumer harm standard . . . ignores the fact that this type of competitive

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[29] *Id.* at ___.

[30] *See* Werden, *“No Economic Sense” Test*, *supra* note 3, at __ (explaining that “[t]he ‘no economic sense’ test inquires into the reasonably anticipated impact of the challenged conduct when undertaken and not into the actual impact of the conduct”) (footnote omitted).

effect analysis is routinely applied in merger analysis."[31] As compared with a pricing decision, an output decision, or any other routine business decision, a decision to merge is a discrete event that is unusual in the life of any given firm and that is assessed by enforcers in the context of a review procedure in which the confidential commercial information of both parties and nonparties is available for analysis. From the premise that a consumer welfare effects test is an appropriate basis for merger evaluation, it simply does not follow that a similar test would be appropriate for single-firm decisions.

Proponents of a consumer welfare effects test return the criticism, claiming that the "no economic sense" test is no less difficult to implement. I am not convinced. One version of this criticism is that the "no economic sense" test requires businesses to do something that they do *not* normally do as part of their standard business planning–compare the effects of proposed business conduct all things considered with the effects of that same conduct in a hypothetical world that holds constant any tendency that the proposed conduct would have to reduce competition.[32] But this is not right. As part of their normal business planning, businesses not only predict whether the proposed conduct makes economic sense, but also identify the bases for that prediction. Because business planning identifies what it is about a proposed course of conduct that would render it profitable–and certainly does so with reference to the expected behavior of rivals–it should not be difficult for businesses to identify if there exist any business benefits isolated from a reduction in competition.

Another administrability criticism leveled against the "no economic sense" test is that it reverses the traditional allocation of burdens in litigation, imposing the burden of production on

[31] Salop, *Flawed Profit Sacrifice Standard*, *supra* note 22, at __.

[32] *Id.* at ___.

the defendant rather than the plaintiff.[33] This criticism lacks bite for two reasons. First, a focus on burden allocations during litigation is beside the point for most businesses, who are more interested in a standard that will enable them to avoid litigation (or at least minimize its risk while carrying out their business strategies). Second, the cost of complying with this burden of production (and thereby developing grounds for terminating the litigation prior to a trial on the merits) pales in comparison with the cost of proceeding through the uncertainties of trial under a vaguely defined consumer welfare standard.[34]

The traditional criticisms of the consumer welfare effects liability standard are correct. The test is too difficult for businesses to apply, it gives rise to too much uncertainty, it creates too high a risk of "false positives," and it leads to costly, lengthy litigation in which judge and jury are left with too little guidance. By contrast, the only objection to the "no economic sense" test that I credit is that it does not capture all anti-competitive single-firm conduct. That admitted defect is not enough to scuttle a test that is not only intelligible to and administrable by courts and businesses, but that also carries a much lower risk of deterring pro-competitive, pro-consumer "hard competition." "No economic sense" is a better test.

B. Essential Facilities

The Commission's second question asks whether the "essential facilities" doctrine should "constitute an independent basis of liability for single-firm conduct under section 2 of the

[33] *Id.* at ___.

[34] *Cf.* R. Hewitt Pate, *Robert H. Jackson at the Antitrust Division*, 68 Albany L. Rev. 787, 788 (2005) (describing the view formed by Justice Jackson at the conclusion of his sole antitrust trial while in private practice that "the antitrust laws are so vaguely expressed that the average business man has no idea when he is and when he is not violating them").

Sherman Act."[35] I will not dwell long on this topic, for the notion that "essential facilities" provides a stand-alone basis for liability is thoroughly discredited.

As the United States' *amicus curiae* brief in *Trinko* stated: "the essential facilities doctrine is 'a label that may aid in the analysis of a monopoly claim, not a statement of a separate violation of law.'"[36] Although *Trinko* did not adopt this position explicitly, the opinion strongly suggests that the Court would refuse to recognize "essential facilities" as an independent type of section 2 claim. The opinion addresses "essential facilities" almost in passing, noting that the Court has "never recognized such a doctrine," and rejecting plaintiff's "essential facilities" argument to the extent that it could perceive one distinct from plaintiff's general section 2 argument.[37] Were the Court to face the issue directly, one expects that it would treat "essential facilities" as it has "monopoly leveraging"–by requiring the plaintiff asserting such a theory to prove the traditional elements of a section 2 violation.[38]

C. Bundled Rebates and Fidelity Discounts

The Commission's third question is the most difficult–"[w]hat should be the standards for determining when a firm's product bundling or bundled pricing violates Section 2 of the Sherman Act?"[39] This is an area where misapplication of antitrust law carries great potential for wasteful litigation, confusion, and harm to competition. Frankly, recommending against

[35] 70 Fed. Reg. 28902, 28907 (May 19, 2005).

[36] DOJ *Trinko* Brief, *supra* note 2, at 22 (quoting *Viacom Int'l, Inc. v. Time Inc.*, 785 F. Supp. 371, 376 n.12 (S.D.N.Y. 1992)).

[37] *Trinko*, 540 U.S. at 411.

[38] *Id.* at 415 n.4.

[39] 70 Fed. Reg. 28902, 28907 (May 19, 2005).

certiorari in *LePage's, Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (*en banc*), was perhaps the most disappointing experience of my tenure at DOJ. That is not to say this recommendation was a "mistake," because there were interagency issues and issues concerning the inadequate development of the record in that case that had to be taken into account. But an argument could be made that the Supreme Court should have granted review because *any* objective basis for decision would be better than the absence of such a basis reflected in *LePage's*.

The *LePage's* decision violates the basic principle that antitrust courts proceeding in the face of uncertainty about the appropriate standard should not impose liability without articulating a clear basis for that imposition of liability. Whether the standard be broad or narrow, what matters is that there must be *some* objective standard by which competitors can evaluate their conduct. In affirming a plaintiff's jury verdict imposing section 2 liability on defendant 3M for its bundled rebates and exclusive dealing arrangements,[40] the Third Circuit neither required LePage's to show that it was unable to make offers comparable to 3M's nor that it would have been impossible for an equally efficient rival to compensate for 3M's offers.[41] Attending to these questions would have forced the Court to hone in on the issues relevant to determining whether 3M's conduct truly threatened to reduce competition.

There was no dispute that 3M's prices were above cost (however cost is calculated).[42] But the Court rejected 3M's attempted importation of the *Brooke Group* standard from predatory

[40] *LePage's, Inc. v. 3M*, 324 F.3d 141, 169 (3d Cir. 2003) (*en banc*).

[41] *See LePage's*, 324 F.3d at 175 (Greenberg, J., dissenting) ("LePage's did not even attempt to show that it could not compete by calculating the discount that it would have had to provide in order to match the discounts offered by 3M through its bundled rebates, and thus its brief does not point to evidence along such lines."); *id.* at 177 (discussing concession of LePage's expert that LePage's was less efficient than 3M).

[42] *LePage's*, 324 F.3d at 147 n.5.

pricing into bundled discounts.[43] This rejection is understandable, because "[u]nlike a low but above-cost price on a single product, a bundled rebate or discount can–under certain theoretical assumptions–exclude an equally efficient competitor, if the competitor competes with respect to but one component of the bundle and cannot profitably match the discount aggregated over the other products, even if the post-discount prices for both the bundle as a whole and each of its components are above cost."[44] In time it may become clear that *Brooke Group* provides the only sort of test that courts can reliably administer in a practical, predictable manner. But *Brooke Group* was not on all fours, and there was room for legitimate debate about its extension to the area of bundled discounts.

The Third Circuit's analysis, however, neglected the potential pro-competitive aspects of bundled discounting. Despite their potential for being implemented in an anti-competitive manner, bundled discounts also have the potential to be pro-competitive, for example by expanding demand or by facilitating economies of scale.[45] The Court did not ask, as it should

[43] *See Brooke Group, Ltd. v. Brown & Williamson Tobacco Co.*, 509 U.S. 209, 222 (1993) ("[A] plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs."). The Third Circuit rejected the argument that, after *Brooke Group*, "no conduct by a monopolist who sells its product above cost–no matter how exclusionary the conduct–can constitute monopolization in violation of § 2 of the Sherman Act." 324 F.3d. at 147; *see id.* at 147-52.

[44] Brief for the United States as *Amicus Curiae* at 12-13, No. 02-1865 *3M Co. v. LePage's Inc.* (2004), *available at* http://www.usdoj.gov/atr/cases/f203900/203900.pdf.

[45] *See, e.g.*, Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 Minn. L. Rev. 1688, 1723-24 (2005) (listing potential efficiency-enhancing effects of bundling and bundled discounts, including, *inter alia*, economies of scale, reduced overhead and marketing expenses, stimulation of consumer demand, and lower transaction costs).

have, whether 3M's sales "grew the market or simply had its sales replace those of LePage's."[46] Nor did it inquire "whether 3M's economies of scale had already been exhausted or whether selling more would lead to a substantial reduction in 3M's costs."[47] In fact, the Third Circuit's opinion provides a firm with market power that seeks to offer bundled discounts no way to do so without running a significant risk of section 2 liability.[48] The court's failure to make clear what showing or showings are necessary or sufficient for imposing liability for bundled rebates or exclusive dealing under section 2 is regrettable.

A better path might have been to follow the lead of the Southern District of New York in *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories*.[49] The *Ortho* decision requires the plaintiff to "allege and prove either that (a) the monopolist has priced below its average variable cost or (b) the plaintiff is at least as efficient a producer of the competitive product as the defendant, but that the defendant's pricing makes it unprofitable for the plaintiff to continue to produce."[50] The second *Ortho* prong "effectively applies the *Brooke Group* price-cost test to the defendant's net price of the product facing competition, after apportioning the entire aggregated

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[46] Office of Fair Trading, *Selective Price Cuts and Fidelity Rebates*, Annex C, ¶ 58 (July 2005), *available at* http://www.oft.gov.uk/NR/rdonlyres/DB851D94-1FBE-46EA-85A4-53E4DA0BB0F8/0/oft804.pdf.

[47] *Id.*

[48] *See, e.g.*, Gary P. Zanfagna, "LePage's v. 3M: *A Reality Check*," The Antitrust Source (November 2004), *available at* http://www.abanet.org/antitrust/source/11-04/Nov04-Zanfagna1129.pdf ("If you are a multi-product firm with a significant position in one or more products, and engage in bundled rebates, you face treble damages if your smaller rival can't keep up–period. . . . Consumers [therefore] will not receive the benefit of lower prices through these programs."), quoted in OECD, *Competition on the Merits*, *supra* note 13, at 32 n.94.

[49] 920 F. Supp. 455 (S.D.N.Y. 1996).

[50] *Id.* at 469.

discount to that product. That approach effectively attributes the entire discount to the product sold by a particular plaintiff."[51] The *Ortho* court's alternative standards are useful as necessary conditions for liability because they prevent the penalizing of conduct that does not threaten to reduce competition.[52] But satisfying the second *Ortho* prong should not be a sufficient condition for liability for at least two reasons. First, "it ignores the possibility that a group of sellers might collectively be able to compete profitably against the package discount even if one of them considered separately could not."[53] Second, "[i]f the resulting net price turns out to be below cost . . . then the problem of not taking defendants' multiple-product efficiencies into account remains."[54] LePage's apparently could not have satisfied either of the *Ortho* standards. As mentioned above, it was undisputed that 3M's prices were above cost (however cost is calculated).[55] Moreover, LePage's expert conceded that LePage's was a less efficient competitor than 3M.[56]

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[51] *See* Brief for the United States as *Amicus Curiae* at 17 n.13, No. 02-1865 *3M Co. v. LePage's Inc.* (2004), *available at* http://www.usdoj.gov/atr/cases/f203900/203900.pdf (hereinafter "DOJ *LePage's* Brief").

[52] *See*, OECD, *Competition on the Merits*, *supra* note 13, at 16 (explaining that the "equally efficient firm" test "guards against the danger of protecting competitors rather than competition because, under competitive conditions, a market will be served only by the most efficient firms. Therefore, it is not considered harmful for less efficient firms to be driven out.").

[53] DOJ *LePage's* Brief at 17 n.13.

[54] OECD, *Competition on the Merits*, *supra* note 13, at 33.

[55] *Lepage's*, 324 F.3d at 147 n.5.

[56] *LePage's*, 324 F.3d at 177 (Greenberg, J., dissenting) ("LePage's economist conceded that LePage's is not as efficient a tape producer as 3M. Thus, in this case section 2 of the Sherman Act is being used to protect an inefficient producer from a competitor not using predatory pricing but rather selling above cost.").

Although application of the *Ortho* standards as a screen could have prevented a potential "false positive" in 3M, it is not clear that *Ortho* provides the best analytical framework for all cases. As an initial matter, reliance on the concession of LePage's expert masks difficulties in making judgments of comparative efficiency.[57] Additionally, the "equally efficient competitor" framework is not easily administrable by businesses at the time of decision (unless "equally efficient" means "identical," in which case the test would collapse into a straight-up price-cost analysis). Businesses do not routinely undertake analyses that require them to benchmark their challenged conduct against hypothetical "equally efficient competitors." Implementing a test that would require them to do so in the normal course would expand the need to hire antitrust professionals to assist in making business decisions. Now that I am in private practice, I have reason to like this outcome, but I do not think that is good public policy. A good liability standard should move business behavior in a pro-competitive direction without imposing excessive decision-making costs or chilling hard competition. In the end, it may turn out that only some type of defendant-cost-based standard will meet this goal, even though such a test would be relatively more underinclusive.

D. How Standards for Exclusionary Conduct Should Be Developed

The Commission's final question asks: "How should the standards for exclusionary or anticompetitive conduct be determined (*e.g.*, through legislation, judicial development, *amicus* efforts by DOJ and FTC), particularly if you believe the current standards are not appropriate or clear?"[58] Although the current standards for some types of exclusionary conduct are not clear,

[57] DOJ *LePage's* Brief at 13 n.10 (explaining difficulties associated with "[d]etermining whether a particular firm should be considered equally efficient").

[58] 70 Fed. Reg. 28902, 28907 (May 19, 2005).

the standards for exclusionary conduct should continue to be determined through judicial elaboration taking account of sound economic theory, with particular focus on developing an administrable test that is intelligible enough to provide guidance to businesses seeking to compete aggressively while conforming their conduct to the law.

It is a commonplace that determining the proper liability standard for single-firm conduct is a vexing task.[59] A recent Background Note prepared for the OECD's Competition Committee highlighted the depth of current difficulties with a survey of scholarly literature expressing severe disapproval of the current state of the law.[60] Einer Elhauge has written that exclusionary conduct doctrine "uses a barrage of conclusory labels to cover for a lack of any well-defined criteria for sorting out desirable from undesirable conduct that tends to exclude rivals."[61] Eleanor Fox shares the assessment, having previously charged that "[a] number of contemporary cases on exclusionary practices tend to be noncommittal if not obfuscatory" in their usage of terms such as "anticompetitive."[62] Commentators on the other side of the Atlantic have been similarly unsparing.[63]

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[59] *See, e.g.*, Brief of *Amici Curiae* Economics Professors at 3-4, *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (attributing the difficulty to the "close resemblance between vigorous competitive activities that the law appropriately is designed to encourage in order to promote the public interest, and activities that are anticompetitive and hence damaging to the public welfare," combined with the fact that both types of behavior "are disadvantageous to rivals").

[60] OECD, *Competition on the Merits*, *supra* note 13, at 6-7.

[61] Einer Elhauge, *Defining Better Monopolization Standards*, *supra* note 15, at 342.

[62] Eleanor Fox, *What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect*, 70 Antitrust L.J. 371, 383 (2002).

[63] *See, e.g.*, Vickers, *Abuse of Market Power*, *supra* note 22 , at 3 n.4 (collecting sources).

Indeterminacy in antitrust laws creates uncertainty for businesses. Uncertainty for businesses creates a risk that they will not undertake pro-competitive, pro-consumer activities for fear of becoming embroiled in costly, lengthy litigation. So I could not tell the Commission to resist the temptation to propose legislation unless I had some confidence that enforcement agencies, the courts, and the academy were at least moving in the right direction. I do possess that confidence. For the past few decades, the Supreme Court and lower courts have consistently made use of insights from economic analysis in focusing the antitrust laws on the promotion of competition and consumer welfare. One need not believe that the common law works itself pure in all matters to think that continuing along the current path holds out a reasonable possibility of arriving at administrable liability rules for single-firm conduct that are accurate enough to make the game worth the candle. At this point, we at least have general agreement on the function to be served by antitrust rules. We should continue to work through agency and judicial efforts to improve the specifics. Thank you.