EXECUTIVE SUMMARY

INTRODUCTION

The U.S. antitrust laws reflect a national commitment to the use of free markets to allocate resources efficiently and to spur the innovation that is the principal source of economic growth. Section 2 of the Sherman Act plays a unique role in U.S. antitrust law by prohibiting single-firm conduct that undermines the competitive process and thereby enables a firm to acquire, credibly threaten to acquire, or maintain monopoly power.

Competition and consumers are best served if section 2 standards are sound, clear, objective, effective, and administrable. After more than a century of evolution, section 2 standards have not entirely achieved these goals, and there has been a vigorous debate about the proper standards for evaluating unilateral conduct under section 2. In June 2006, the Department of Justice (Department) and the Federal Trade Commission (FTC) began a series of wide-ranging hearings relating to unilateral conduct under section 2. The hearings encompassed twenty-nine separate panels and were conducted over the course of an entire year. Academics, businesspeople, and antitrust practitioners presented a broad array of views.

This report synthesizes views expressed at the hearings, in extensive scholarly commentary, and in the jurisprudence of the Supreme Court and lower courts. It reflects the Department's enforcement policy and is intended to make progress toward the goal of sound, clear, objective, effective, and administrable standards for analyzing single-firm conduct under section 2.

CHAPTER 1: Overview

Chapter 1 provides an overview of section 2 and its application. This overview explains that the purpose of section 2 is to prevent conduct that harms the competitive process, while not discouraging aggressive competition, whether that aggressive competition is from monopolists or other competitors. Chapter 1 also articulates and elaborates on basic principles that have emerged from court decisions and commentary:

1. Single-firm conduct comes within the scope of section 2 only if the firm possesses, or is likely to achieve, monopoly power.
2. Section 2 does not prohibit the mere possession or exercise of monopoly power.
3. Acquiring or maintaining monopoly power through conduct harming the competitive process should be condemned.
4. Section 2 protects the competitive process but not individual competitors.
5. Distinguishing beneficial competitive conduct from harmful exclusionary or predatory conduct often is difficult.
6. Section 2 standards should prevent conduct that harms the competitive process, but should avoid overly broad prohibitions that suppress legitimate competition.
7. Section 2 standards should be understandable and clear to businesspeople and judges and must account for the possibility of error and administrative costs in their application.

CHAPTER 2: Monopoly Power

Chapter 2 addresses the meaning and identification of monopoly power.

Meaning of a Dominant Market Share. A dominant market share typically is a prerequisite for the possession of monopoly power, but it is only a starting point for determining whether a competitor possesses monopoly power. Competitive conditions must be such that the competitor can persistently charge prices well above competitive levels without substantial erosion of its dominant position through the expansion of incumbent rivals or the entry of new competitors. Where courts have found monopoly power—as opposed to market power—the defendant's market share has been at least fifty percent and typically substantially higher.

When a firm has maintained a market share in excess of two-thirds for a significant period and the Department concludes that market conditions likely would prevent the erosion of its market position in the near future, the Department will presume that the firm possesses monopoly power absent convincing evidence to the contrary.

Market Definition. Defining the market involves an assessment of likely substitution by customers in response to an exercise of monopoly power. This assessment can be problematic in a monopoly-maintenance case because the threshold issue is whether the defendant already possesses, and hence already is exercising, monopoly power. It is important in those cases not to evaluate substitution possibilities at the prevailing monopoly price, but it is difficult to evaluate substitution possibilities at hypothetical prices significantly below prevailing levels. The Department views direct evidence of anticompetitive effects as useful but normally not sufficient by itself to demonstrate monopoly power in the absence of a defined antitrust market.

CHAPTER 3: General Conduct Standards

Chapter 3 initially discusses the importance of an appropriate framework that structures the analysis, including an efficient allocation of burdens of production and proof in litigation. The plaintiff should have the initial burden of establishing that challenged conduct harms the competitive process and therefore has a potentially anticompetitive effect. If plaintiff carries that burden, defendant should have the opportunity to proffer and substantiate a procompetitive justification for the challenged conduct. If defendant does so, plaintiff then should have the burden of establishing that the challenged conduct is anticompetitive under the applicable standard. This allocation can enable courts to resolve cases more quickly and efficiently.

Turning to the general tests, the Department does not believe that any one test works well in all cases and encourages the development of conduct-specific tests and safe harbors, which are discussed in subsequent chapters. The five general tests discussed in the chapter are:

Effects-Balancing. Although focusing analysis on the effect on consumer welfare is appropriate, the Department does not believe that using an effects-balancing test as a general standard under section 2 is likely to maximize consumer welfare. The Department believes that it is better for long-run economic growth and consumer welfare not to incur the costs and errors from attempting to quantify and precisely balance procompetitive and anticompetitive effects as required under this test.

Profit-Sacrifice. The Department believes that a profit-sacrifice test that asks whether conduct is more profitable in the short run than other less-exclusionary conduct the firm could have undertaken raises serious concerns of enforcement error and administrability and should not be the test for section 2 liability. The Department believes that a firm should not be liable for failure to maximize its profits.

No-Economic-Sense. The Department finds the no-economic-sense test useful, among other things, as a counseling device to focus businesspeople on the reasons for undertaking potentially exclusionary conduct. At the same time, the Department does not believe that a trivial benefit should protect conduct that is significantly harmful to consumers and the competitive process. Therefore, the Department does not believe that this test should serve as the general standard under section 2.

Equally Efficient Competitor. The Department finds it useful to ask in pricing cases whether conduct would exclude an equally efficient competitor. In non-pricing cases, that inquiry does not readily lead to administrable rules, and, even in pricing cases, there is difficulty in comparing the efficiency of two firms doing different things. Accordingly, the Department does not believe that this test should be the general standard for liability under section 2.

Disproportionality. In the absence of an applicable conduct-specific test, the Department believes that conduct should be unlawful under section 2 if its anticompetitive effects are shown to be substantially disproportionate to any associated procompetitive effects. While also subject to valid criticism, the test focuses on the consumer-welfare goals of antitrust and represents the best combination of effectiveness and administrability (including the need to avoid chilling beneficial competition) of the general tests identified to date.

CHAPTER 4: Predatory Pricing

Chapter 4—the first chapter addressing a specific category of potentially exclusionary conduct—focuses on predatory pricing. In 1993 the Supreme Court held that a plaintiff alleging predatory pricing must show that the defendant cut prices below an appropriate measure of its costs and had a dangerous probability of recouping its investment in below-cost prices. While acknowledging that above-cost pricing can sometimes be exclusionary, the Court held that attempting to identify such instances would harm beneficial price competition. The Department believes that the Court's holding is consistent with promoting competition and consumer welfare under section 2.

Measure of Cost. The courts have not settled on an appropriate measure of cost for evaluating predatory-pricing claims. Consistent with the thinking expressed in case law, the Department concludes that the appropriate measure of cost should identify loss-creating sales that could force an equally efficient rival out of the market and that such a measure should be administrable by businesses and the courts.

In most cases, the best cost measure likely will be average avoidable cost. This measure of cost includes fixed costs to the extent that they were incurred only because of the predatory strategy, for example, as a result of expanding capacity to enable the predatory sales. When an increment to a defendant's output associated with the predatory strategy cannot be identified, the best cost measure typically is average variable cost. The Department does not favor the use of average variable cost in general because it does not focus on the predatory scheme itself and does not indicate as reliably whether the firm might be losing money to achieve anticompetitive ends.

Recoupment. The Department believes that the recoupment requirement is an important reality check in assessing predatory-pricing allegations. Without a dangerous probability that the investment in below-cost prices will be recouped through later supracompetitive pricing, below-cost prices most likely reflect nothing more than intense price competition that is in the interests of consumers. In some cases, focusing first on recoupment may avoid difficult issues in comparing prices with costs. The Department believes that recoupment outside the relevant market may be relevant in some cases.

Predatory Bidding. In 2007 the Supreme Court applied its two-part test for predatory pricing to predatory bidding. The Court reasoned that, in important respects, predatory bidding is the mirror image of predatory pricing and therefore that the same sort of analysis is required to avoid chilling procompetitive conduct. The Department supports the Court's ruling and analysis.

CHAPTER 5: Tying

Chapter 5 discusses various forms of tying—selling a product only on the condition that the buyer also purchase a second product. Examples of tying include contractual restrictions on future purchases of consumable complements to a durable good, the simultaneous sale of two or more products only in a bundle, and linking two products technologically.

In some circumstances, tying can allow a competitor with monopoly power over one product to acquire monopoly power in a tied product or to maintain its monopoly in the tying product. Those circumstances, however, are limited.

In many others, tying can promote efficiency and benefit consumers through a reduction in production or distribution costs. It also can be used to price discriminate, which generally does not create or maintain monopoly power. Consequently, the Department believes that the historical hostility of the law to tying is unjustified. In particular, the qualified rule of per se illegality applicable to tying is inconsistent with the Supreme Court's modern antitrust decisions and should be abandoned.

Tying in the form of technologically linking products is an area where enforcement intervention poses a particular risk of harming consumers more than it helps them in the long run. Technological tying often efficiently gives consumers features they want and judicial control of product design risks chilling innovation. This form of tying, therefore, should be condemned only in exceptional cases, such as when integrating two separate products serves no purpose other than to disadvantage competitors and harms the competitive process.

CHAPTER 6: Bundled and Loyalty Discounts

Chapter 6 considers two particular pricing practices: bundled discounts and loyalty discounts.

Bundled Discounts. When a defendant's rivals can effectively compete on a bundle-to-bundle basis, bundled discounting is much like single-product price cutting, and the practice is best analyzed as predatory pricing.

When a defendant's rivals cannot compete bundle-to-bundle, discounts or rebates work more like tying, and a different analysis is appropriate. In those circumstances, the Department believes a cost-based safe harbor for bundled discounting, in which an imputed price for the item (or items) in the bundle potentially subject to competition is computed by allocating to that item (or items) the entire discount or rebate received by a customer, is appropriate. The rationale of this safe harbor is that an equally efficient competitor that does not sell all the items in the bundle would not be excluded if this imputed price exceeds an appropriate measure of a defendant's cost.

Bundled discounting failing this safe harbor is not necessarily anticompetitive and should not be presumed to be so. Rather, a plaintiff should be required to demonstrate that the practice has harmed the competitive process or likely would do so if allowed to continue. If the defendant demonstrates that the practice has a procompetitive explanation, it should be condemned only if plaintiff demonstrates a substantially disproportionate anticompetitive harm.

Loyalty Discounts. Chapter 6 also considers single-product loyalty discounts. Single-product loyalty discounts often are procompetitive, but they can be anticompetitive under certain limited circumstances. The Department is inclined to treat this practice as predatory pricing and therefore consider the discounting lawful unless the seller's revenues are less than an appropriate measure of its costs. This approach is administrable, guards against chilling legitimate discounting, and is especially appropriate if the seller's rivals can reasonably compete for the entirety of a customer's purchases.

When a significant portion of a customer's purchases are not subject to meaningful competition, the Department recognizes the possibility that single-product loyalty discounts might produce an anticompetitive effect even though the discounted price over all of a customer's purchases exceeds the seller's cost. Accordingly, the Department believes that further study of the real-world impact of the practice is necessary before concluding that standard predatory-pricing analysis is appropriate in all cases.

CHAPTER 7: Unilateral, Unconditional Refusals to Deal with Rivals

Chapter 7 discusses unilateral, unconditional refusals by firms with monopoly power to deal with their rivals. Such refusals can include refusing to sell inputs, license intellectual property rights, or share scarce resources. In certain decisions, the Supreme Court held that such refusals violated section 2, but the Court's most recent decision on this subject took a very cautious approach. Compelling access to inputs, property rights, or resources undoubtedly can enhance short-term price competition, but doing so can do more harm than good to the competitive process over the longer term.

The Department agrees with the Court that forcing a competitor with monopoly power to deal with rivals can undermine the incentive of either or both to innovate. The Department also agrees with the Court that judges and enforcement agencies are ill-equipped to set and supervise the terms on which inputs, property rights, or resources are provided. Thus, the Department concludes that antitrust liability for mere unilateral, unconditional refusals to deal with rivals should not play a meaningful role in section 2 enforcement.

CHAPTER 8: Exclusive Dealing

Chapter 8 addresses the practice of exclusive dealing. Exclusive dealing can enhance efficiency by aligning the incentives of trading partners, by preventing free riding, and in other ways. Exclusive dealing also can undermine the competitive process by, for example, barring smaller competitors from efficient distribution channels and denying them the ability to operate at efficient scale.

The Department believes that exclusive-dealing arrangements foreclosing less than thirty percent of existing customers or effective distribution should not be illegal. The Department does not believe that the legality of an exclusive-dealing arrangement should be determined solely by the explicit duration of the contract or agreement. When a firm with lawful monopoly power utilizes exclusive dealing, the Department will examine whether the exclusive dealing contributed significantly to maintaining monopoly power and whether alternative distribution channels allow competitors to pose a real threat to the monopoly before potentially imposing liability.

CHAPTER 9: Remedies

Chapter 9 focuses on remedies in section 2 cases. Implementing effective remedies is key to section 2 enforcement.

Equitable Remedies. Section 2 equitable remedies should terminate a defendant's unlawful conduct, prevent its recurrence, and re-establish the opportunity for competition. And they should do so without imposing undue costs on the court or the parties, without unnecessarily chilling legitimate competition, and without undermining incentives to invest and innovate. This often is a daunting challenge.

The Department believes that prohibiting a defendant from engaging in specific acts, defined by clear and objective criteria, is the proper remedy if it would be effective. In some circumstances, however, re-establishing the opportunity for competition requires the imposition of additional affirmative obligations on defendant. Structural remedies, including various forms of divestiture, may be appropriate if there is a clear, significant causal connection between defendant's monopoly power and the unlawful acts. Radical restructuring of the defendant, however, is appropriate only if there is no other way to achieve the remedial goals and the determination is made that such restructuring would likely benefit consumers.

Monetary Remedies. The Department believes that further consideration of appropriate monetary damages and penalties for section 2 violations may be useful.

CHAPTER 10: International Perspective

Chapter 10 offers an international perspective. Over one hundred nations have antitrust laws, nearly all including provisions on single-firm exclusionary conduct, but there are significant differences among various countries' laws, legal institutions, and enforcement policies. With increasingly globalized markets, the diversity of competition regimes has raised concerns. Firms doing business globally, when confronted with, for example, a product-design decision, may be pushed to conform to the rules of the most restrictive jurisdiction. Certain types of remedies, such as mandatory disclosures of intellectual property, also have global impacts.

The Department and the FTC have addressed the challenges posed by multi-jurisdictional enforcement against single-firm exclusionary conduct in several ways. They have entered into bilateral cooperation agreements with seven countries and the European Communities. They actively participate in several international organizations, such as the International Competition Network and the Organisation for Economic Co-Operation and Development. And they provide technical assistance to nations in the early stages of adopting and implementing antitrust laws. The Department will continue to explore ways of strengthening cooperation with counterparts in other jurisdictions and increasing convergence on sound enforcement policies.

CONCLUSION

The Department believes that the hearings advanced the debate with respect to the appropriate legal standards for single-firm conduct under section 2 of the Sherman Act. The Department hopes that this report will contribute to the public debate in this complex but important area, and that it makes progress toward the goal of sound, clear, objective, effective, and administrable standards for analyzing single-firm conduct. The Department, of course, will continue to review the legal and economic scholarship in this area, to learn from its own investigations and cases, to consult with other enforcement officials, and to engage in the public dialogue over how best to advance that goal in the future.