

CHAPTER 3

GENERAL STANDARDS FOR EXCLUSIONARY CONDUCT

I. Introduction

As discussed in chapter 1, the Supreme Court's description of conduct that violates section 2 in *United States v. Grinnell Corp.*—"the willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident"¹—provides little useful guidance.² The trial court's instruction to the jury approved in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, that a refusal to deal with a competitor is lawful if justified by "valid business reasons,"³ has proven similarly unavailing as a source of specific guidance because of uncertainty over what constitutes a valid business reason. Indeed, commentators draw quite different conclusions from that instruction.⁴

While the Supreme Court has established conduct-specific tests for predatory pricing and bidding, it has neither articulated similarly explicit standards for many other types of potentially exclusionary conduct nor adopted a

test applicable to all conduct.⁵ The lower courts also have not settled on either a general test or conduct-specific tests.⁶

Accordingly, there has been increasing focus in recent years on developing more refined tests to determine whether conduct is anticompetitive under section 2. This effort has been informed, in large part, by the following principles set forth in chapter 1:

- Unilateral conduct is outside the purview of section 2 unless the actor possesses monopoly power or is likely to achieve it.
- The mere possession or exercise of monopoly power is not an offense; the law addresses only the anticompetitive acquisition or maintenance of such power (and certain related attempts).
- Acquiring or maintaining monopoly power through assaults on the competitive process harms consumers and is to be condemned.
- Mere harm to competitors—without harm to the competitive process—does not violate section 2.
- Competitive and exclusionary conduct can look alike—indeed, the same conduct can have both beneficial and exclusionary

¹ *United States v. Grinnell Corp.*, 384 U.S. 563, 570–71 (1966).

² See, e.g., 1 SECTION OF ANTITRUST LAW, AM. BAR ASS'N, ANTITRUST LAW DEVELOPMENTS 210, 242 (6th ed. 2007) (noting that "the highly abstract *Grinnell* language . . . has been criticized as not helpful in deciding concrete cases"); 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, ¶ 651b, at 74 (2d ed. 2002) (describing the *Grinnell* formulation as "not helpful" and "sometimes misleading").

³ 475 U.S. 585, 597 (1985) (quoting trial court).

⁴ See generally Mark S. Popofsky, *Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules*, 73 ANTITRUST L.J. 435, 439 (2006) ("[A]dvocates of rival Section 2 tests treat *Aspen* as a mirror, reflecting support for their favored doctrine.").

⁵ See, e.g., *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 409 (2004) (not adopting a specific test and characterizing *Aspen Skiing* as at the outer boundaries of section 2 enforcement without further explanation); *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1993); see also *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

⁶ Compare, e.g., *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 903 (9th Cir. 2008) (applying a cost-based test to bundled discounting), with *LePage's Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003) (en banc) (condemning bundled discounting practices without applying a cost-based test).

effects—making it hard to distinguish conduct that should be deemed unlawful from conduct that should not.

- Because competitive and exclusionary conduct often look alike, courts and enforcers need to be concerned with both underdeterrence and overdeterrence.
- Standards for applying section 2 should take into account the costs, including error and administrative costs, associated with courts and enforcers applying those standards in individual cases and businesses applying them in their own day-to-day decision making.

While there is general consensus that clearer and more predictable standards are desirable, legal scholarship and the record from the hearings suggest far less consensus on what those standards should be.⁷ Some advocate a single test for analyzing all, or substantially all, conduct challenged under section 2, but there is no agreement on what that single test should be.⁸ Others maintain that no unitary test can be

⁷ See, e.g., Sherman Act Section 2 Joint Hearing: Tying Hr'g Tr. 59, Nov. 1, 2006 (Popofsky) (“[T]here is a holy war raging over the appropriate liability standard under Section 2 generally.”); Popofsky, *supra* note 4, at 435 (“The antitrust community is engaged in a renewed debate over the legal test for exclusionary conduct under Section 2 of the Sherman Act.”).

⁸ See, e.g., Sherman Act Section 2 Joint Hearing: Conduct as Related to Competition Hr'g Tr. 31, May 8, 2007 [hereinafter May 8 Hr'g Tr.] (Pitofsky) (advocating a framework whereby “procompetitive justifications” are balanced against “anticompetitive effects”); Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 330 (2003) (advocating rules of per se legality and illegality based on monopolist’s efficiency); A. Douglas Melamed, *Exclusive Dealing Agreements and Other Exclusionary Conduct—Are There Unifying Principles?*, 73 ANTITRUST L.J. 375, 389 (2006) (advocating a “test” under which “conduct is anticompetitive if, but only if, it makes no business sense or is unprofitable for the defendant but for the exclusion of rivals and resulting supra-competitive recoupment”); Mark R. Patterson, *The Sacrifice of Profits in Non-Price Predation*, ANTITRUST, Fall 2003, at 37, 43 (stating that “the sacrifice-of-profits test provides a desirable approach both for litigation and business planning”); Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 ANTITRUST L.J. 311, 341 (2006) (proposing a standard

applied to the broad range of conduct that may be subject to challenge under section 2.⁹ Some urge development of specific tests or safe harbors for specific categories of conduct.¹⁰

where “the court would evaluate the likelihood and magnitude of expected consumer benefits or harms based on the information reasonably available at the time that the conduct was undertaken”).

⁹ See, e.g., ANTITRUST MODERNIZATION COMM’N, REPORT AND RECOMMENDATIONS 91 (2007), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf (“Many commentators are skeptical that any one legal standard should be used to evaluate the wide variety of different types of conduct that may be challenged under Section 2.”); May 8 Hr'g Tr., *supra* note 8, at 21 (Rule) (“The problem with the unitary standards is . . . [that] they presume a . . . capability of regulators and enforcers and courts to distinguish efficient from inefficient conduct that just doesn’t exist.”); Sherman Act Section 2 Joint Hearing: Section 2 Policy Issues Session Hr'g Tr. 12, May 1, 2007 [hereinafter May 1 Hr'g Tr.] (McDavid) (recommending that the search for a single standard be abandoned and noting that antitrust is “very fact-specific”); *id.* at 56 (Jacobson) (“I think the consensus today is that there cannot be a single test for all aspects of [section 2] conduct”); Sherman Act Section 2 Joint Hearing: Monopoly Power Session Hr'g Tr. 172, Mar. 7, 2007 (Sims) (stating that there is no consensus for section 2 approaches except to pay attention to the facts); Sherman Act Section 2 Joint Hearing: International Issues Session Hr'g Tr. 15, Sept. 12, 2006 [hereinafter Sept. 12 Hr'g Tr.] (Lowe) (“[O]ne test may not be the final answer to the analysis we need to carry out. There may be several tests which have been proposed which are relevant to a particular case.”); *id.* at 101–02 (Addy) (asserting that “we should [not] expect the kind of detail or precision that some proponents might advocate” and that “there is no Holy Grail”).

¹⁰ See, e.g., Sherman Act Section 2 Joint Hearing: Business Testimony Session Hr'g Tr. 95–96, Feb. 13, 2007 [hereinafter Feb. 13 Hr'g Tr.] (Stern) (stating that meaningful safe harbors that clarify what is clearly legal and not questionable should be developed); Sherman Act Section 2 Joint Hearing: Academic Testimony Session Hr'g Tr. 161–62, Jan. 31, 2007 [hereinafter Jan. 31 Hr'g Tr.] (Gilbert) (advocating different standards for different types of behavior); *id.* at 117 (Bloom) (“[W]e may need more than one test . . . to cover different types of exclusionary conduct.”); *id.* at 130 (Rill) (advocating that conduct safe harbors be developed). *But cf.* Melamed, *supra* note 8, at 384 (contending that different rules for different types of conduct “would be problematic in practice” because “[d]ifferent rules . . . would inevitably invite disputes about how the conduct at issue should be categorized”).

This chapter first discusses the allocation of burdens of production and proof in section 2 cases, an important issue no matter the substantive test adopted. The chapter then turns to five tests that have been proposed as a general standard for assessing whether conduct is anticompetitive under section 2—namely, (1) the effects-balancing test, (2) the profit-sacrifice test, (3) the no-economic-sense test, (4) the equally efficient competitor test, and (5) the disproportionality test.¹¹ The chapter briefly describes the tests and assesses the relative advantages and disadvantages of each against modern Supreme Court section 2 jurisprudence and the principles set forth in chapter 1.

II. Allocation of Burdens of Production and Proof

Regardless of the substantive standard applied, the proper allocation of burdens of production and proof is key to facilitating the efficient resolution of cases that are notoriously complex, time consuming, and expensive.¹² As the Supreme Court has observed, “[P]roceeding to antitrust discovery can be expensive” as it sometimes entails “a potentially massive factual controversy.”¹³ Allocating burdens can enable courts more quickly to dispose of non-meritorious cases and sometimes to identify violations.¹⁴

¹¹ The chapter focuses on five prominent tests, although others have been proposed. *See, e.g.*, Elhauge, *supra* note 8, at 330; Kenneth L. Glazer & Brian R. Henry, *Coercive vs. Incentivizing Conduct: A Way Out of the Section 2 Impasse?*, ANTITRUST, Fall 2003, at 45, 47–48.

¹² *See* Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 17 (1984); Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 ANTITRUST L.J. 3, 64 (2004).

¹³ *Bell Atl. Corp. v. Twombly*, 127 S. Ct. 1955, 1967 (2007) (quoting *Associated Gen. Contractors of Cal., Inc. v. Carpenters*, 459 U.S. 519, 528 n.17 (1983)); *see also, e.g.*, Feb. 13 Tr., *supra* note 10, at 209 (Sewell) (noting that firms “expend[] an enormous amount of resources, legal resources, trying to figure out” what is illegal under section 2).

¹⁴ *See* HERBERT HOVENKAMP, *THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION* 108 (2005) (observing that a “staged inquiry is particularly conducive to summary judgment or other early termination of the dispute”).

Excessively lengthy antitrust litigation helps neither businesses nor consumers. As one commentator observed, it can be impossible to obtain effective relief in a matter that drags on for years and years before resolution: “As litigation stretches on—perhaps with no interim relief—the competitive moment that brought forth the rival may be lost, and along with it the prospect of new or improved products and services.”¹⁵ Lengthy litigation of non-meritorious claims can have similarly harmful competitive effects by restraining innovative or efficient conduct.

Noting the costs and complexities of section 2 litigation, several panelists voiced concern about the process of deciding such cases. One panelist stressed the need for a “sound analytical framework” for deciding section 2 claims.¹⁶ Another noted that merely “punt[ing] issues downstream to juries . . . leads to forced settlement because people are risk averse and don’t want to go to trial.”¹⁷ Another expressed the view that pressure to settle can lead to “a lot of hidden false positives . . . particularly in the private cases.”¹⁸

One commentator explains:

To be effective, antitrust rules must be “operative,” i.e., they must work reasonably well in the context of litigation where they are ultimately going to be applied. That means they must be structured to take into account such basic litigation features as due process, burdens of pleading, production, and proof, and rules of evidence. Rules that make perfect sense as a matter of economics may not make sense from the point of view of procedure.¹⁹

¹⁵ Gavil, *supra* note 12, at 80.

¹⁶ May 1 Tr., *supra* note 9, at 17 (Kolasky).

¹⁷ Sherman Act Section 2 Joint Hearing: Loyalty Discounts Session Hr’g Tr. 186, Nov. 29, 2006 [hereinafter Nov. 29 Hr’g Tr.] (Crane).

¹⁸ Jan. 31 Tr., *supra* note 10, at 73–74 (Shelanski).

¹⁹ Gavil, *supra* note 12, at 66; *cf.* HOVENKAMP, *supra* note 14, at 105 (“If the rule of reason is to be administered rationally through the costly antitrust enterprise, it should never be an unfocused inquiry into all aspects of a defendant’s business.”).

A proper allocation of the burdens can help “limit the cases that proceed to discovery and trial” and “structure the proceedings in the rest, leading courts to focus on the most important issues.”²⁰

The D.C. Circuit outlined a useful procedural framework for distinguishing exclusionary from competitive acts. First, “[T]o be condemned as exclusionary, a monopolist’s act must have an ‘anticompetitive effect.’ That is, it must harm the competitive *process* and thereby harm consumers. . . . [And] the plaintiff, on whom the burden of proof of course rests, must demonstrate that the monopolist’s conduct indeed has the requisite anticompetitive effect.”²¹ Second, “[I]f a plaintiff successfully establishes a prima facie case under § 2 by demonstrating anticompetitive effect, then the monopolist may proffer a [nonpretextual] ‘procompetitive justification’ for its conduct.”²² Third, “[I]f the monopolist’s procompetitive justification stands un rebutted, then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit.”²³

Requiring plaintiffs to make a showing of harm to the competitive process at the outset facilitates the disposition of non-meritorious claims. One commentator describes this type of requirement as an “important initial filter[]”²⁴ that can “weed[] out either at the pleading stage or the summary judgment stage”²⁵ meritless claims. Likewise, requiring a defendant, upon a prima facie showing of harm to the

competitive process, to come forward with a nonpretextual justification for its conduct enables courts and juries to condemn patently anticompetitive conduct without any weighing of offsetting effects.²⁶

These steps can spare courts and juries difficult questions. In many cases, the plaintiff will not be able to make a plausible showing of harm to the competitive process, or the defendant will not be able to muster a plausible efficiency-enhancing rationale for its conduct, meaning that the court or jury can readily determine whether or not the conduct is anticompetitive. In effect, this approach “strip[s] away those explanations that are implausible or unproven until we have a ‘core’ left that characterizes the practice as pro- or anticompetitive.”²⁷

The Department urges courts to apply such a procedural framework and to consider litigation costs and the substantive goals of antitrust when allocating the burdens of proof and production.

III. Proposed General Standards

If the allegation of competitive harm is not meritless but the conduct is not patently anticompetitive, the standard for evaluating the conduct plays a crucial role in ensuring that section 2 promotes competition and consumer welfare. This section discusses five general tests that have been proposed for determining whether or not challenged conduct is anticompetitive.

A. Effects-Balancing Test

Given the objective of identifying conduct that causes harm to the competitive process, it is natural that some commentators and courts favor applying an effects-balancing test that focuses on a challenged practice’s “overall impact on consumers” or net effects on consumer welfare.²⁸ The test asks whether

²⁰ Easterbrook, *supra* note 12, at 18.

²¹ *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001) (en banc) (per curiam) (citations omitted) (emphasis in original).

²² *Id.* at 59.

²³ *Id.*

²⁴ Gavil, *supra* note 12, at 62.

²⁵ *Id.* at 75; *see also* Easterbrook, *supra* note 12, at 17 (endorsing “filters” that “help to screen out cases in which the risk of loss to consumers and the economy is sufficiently small that there is no need of extended inquiry and significant risk that inquiry would lead to wrongful condemnation or to the deterrence of competitive activity as firms try to steer clear of the danger zone”).

²⁶ *Cf.* Gavil, *supra* note 12, at 80.

²⁷ HOVENKAMP, *supra* note 14, at 108.

²⁸ Salop, *supra* note 8, at 330. It is not always clear whether the consumer-welfare test focuses only on consumer surplus or includes both consumer and producer surplus. *See* Sherman Act Section 2 Joint

particular conduct “reduces competition without creating a sufficient improvement in performance to fully offset these potential adverse effect[s] on prices and thereby prevent consumer harm.”²⁹ At its core, the test entails quantifying and weighing procompetitive and anticompetitive effects of the challenged conduct.

The effects-balancing test makes illegal all conduct by which a monopolist acquires or maintains monopoly power where the conduct causes net harm to consumers. The effects-balancing test has the advantage of focusing the exclusionary-conduct analysis on the impact on consumers, a key concern of Sherman Act jurisprudence.³⁰

Critics of this test contend that it is not easily administrable and is inconsistent with the Supreme Court’s recent section 2 jurisprudence.³¹ Administrability is crucial, as then-Judge Breyer explained in *Barry Wright Corp. v. ITT Grinnell Corp.*: “Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve.”³²

Recent Supreme Court decisions have reflected then-Judge Breyer’s appreciation of the need to adopt standards that reasonably identify truly anticompetitive conduct, minimizing administrative costs and risk of Type I and Type II errors that would ultimately undermine effective antitrust enforcement. The Supreme Court has realized that a search for every possible anticompetitive effect can do more harm than good. The Court’s predatory-

Hearing: Predatory Pricing Hr’g Tr. 178–190, June 22, 2006 [hereinafter June 22 Hr’g Tr.]; *id.* at 180 (Salop) (“I think by consumer welfare I mean true consumer welfare.”); *id.* at 184 (Salop) (noting that “what the Supreme Court meant by consumer welfare is total welfare”).

²⁹ Salop, *supra* note 8, at 330.

³⁰ *See id.* at 330–32.

³¹ *See, e.g.,* Popofsky, *supra* note 4, at 464 (stating that the effects-balancing test “cannot be reconciled with certain . . . Section 2 rules”).

³² 724 F.2d 227, 234 (1983).

pricing test in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, for example, provides a safe harbor for pricing above a relevant measure of cost, even though the Court explicitly recognized a possibility of such pricing causing consumer harm through the exclusion of rivals.³³ Similarly, in *Trinko*, the Court observed that violations of certain sharing duties imposed by statute may be “‘beyond the practical ability of a judicial tribunal to control,’” even where enforcement of such duties might increase competition in the short run.³⁴

The effects-balancing test confronts a court with the administrative challenge of conducting an open-ended measuring of effects that includes comparing the existing world with a hypothetical world that is subject to debate. These administrability problems include limitations on both the ability of economists accurately to measure the net consumer-welfare effects of particular conduct³⁵ and the ability of judges and juries to evaluate this evidence.³⁶

³³ 509 U.S. 209, 223 (1993).

³⁴ *Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 414 (2004) (quoting *Brooke Group*, 509 U.S. at 223); *see also* *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069, 1078 (2007) (holding that, while higher bidding for inputs may potentially have exclusionary effects even where it does not result in below-cost output pricing, such effects are “‘beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate’ procompetitive conduct” (quoting *Brooke Group*, 509 U.S. at 223)).

³⁵ *See, e.g.,* Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2: The “No Economic Sense” Test*, 73 ANTITRUST L.J. 413, 431–32 (2006).

³⁶ *See, e.g.,* Elhauge, *supra* note 8, at 317 (The “open-ended balancing inquiry” required by an effects-balancing test, when performed by “antitrust judges and juries[,] would often be inaccurate, hard to predict years in advance when the business decision must be made, and too costly to litigate.”); Melamed, *supra* note 8, at 386–87 (noting that the effects-balancing test would “pose a daunting challenge to any decision maker”); Popofsky, *supra* note 4, at 465 (observing that “the inquiry adjudicators need to make” under the effects-balancing test “is too difficult”); Werden, *supra* note 35, at 431–32 (“Reliance on the jury system assures that the consumer-welfare test would result in a high incidence of false positive findings of exclusionary conduct.”).

Indeed, several panelists and commentators have pointed out that, in practice, courts do not engage in the precise balancing called for by the effects-balancing test. One panelist explained that, “when you look at the decisions, the courts never reach [a] final balancing stage.”³⁷ Another panelist agreed, stating that no “court has ever written an opinion saying, now that it is all over, we find that there are these harms and these efficiencies and we are now going to weigh them and we are going to choose between the two.”³⁸ Similarly, in commenting on the D.C. Circuit’s *Microsoft* decision,³⁹ another asserts that the court, “while using the language of comparing effects, in fact *avoided* that inquiry.”⁴⁰

The effects-balancing test also may lead courts to focus too much on static, short-run consumer effects. Because dynamic effects are often more difficult to assess than static effects, the effects-balancing test may well be misapplied to condemn conduct with dynamic effects that benefit consumers significantly. As one commentator notes, “Even if economists could perfectly sort out the relatively short-run economic consequences of all marketplace conduct, they still could not accurately account

But see Salop, *supra* note 8, at 314 (“Although [the consumer-welfare] standard has been criticized, it can be implemented without causing excessive false positives that might lead to over-deterrence or a welfare-reducing diminution in innovation incentives.”).

³⁷ May 1 Hr’g Tr., *supra* note 9, at 60 (Kolasky).

³⁸ *Id.* at 103 (Krattenmaker); *see also* May 8 Hr’g Tr., *supra* note 8, at 30 (Melamed) (“[T]o talk about . . . balancing as a solution to the problem where you have both benefit and harm . . . is nonsense. And I don’t think any court does it.”); *id.* at 32 (Rule) (stating that balancing “becomes infinitely more difficult . . . in a Section 2 context for a variety of reasons”); May 1 Hr’g Tr., *supra* note 9, at 81 (Calkins) (“[Y]ou never get to the last step, and so it is not really a balancing.”). *But see* May 8 Hr’g Tr., *supra* note 8, at 31 (Pitofsky) (“The balancing test is the baseline of all antitrust. . . . Why do you single out Section 2 of the Sherman Act as an area where balancing is nonsense?”).

³⁹ *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (en banc) (per curiam).

⁴⁰ Popofsky, *supra* note 4, at 445 (emphasis in original).

for the important long-term effects of any remedial action on incentives for innovation and risk-taking—the twin engines of our prosperity.”⁴¹ To the extent it is applied in a manner that focuses more on short-run consumer effects of specific conduct, the effects-balancing test may ultimately harm, rather than benefit, consumers in the long run.

Further, critics note that the complexity of administering the effects-balancing test would make it difficult for firms to determine at the outset whether specific conduct would violate section 2, thereby potentially chilling pro-competitive conduct and reducing consumer welfare.⁴² Moreover, a legal rule under which every action of a monopolist must be scrutinized for net consumer-welfare effects threatens to chill a monopolist’s incentives to engage in procompetitive conduct out of fear of antitrust investigation, litigation, or even mistaken liability—again, potentially harming consumer welfare.

Given the open-ended nature of the effects-balancing test and the inherent uncertainty for businesses in predicting its outcome, the Department does not believe it should be the general test for analyzing conduct under section 2. Although consumer welfare should remain the goal of enforcement efforts, that objective likely is better served by a standard that takes better account of administrative costs and the benefits of dynamic competition for economic growth.

The Department does not believe that the effects-balancing test should be the general test for analyzing conduct under section 2.

⁴¹ *Id.* at 431–32.

⁴² *See, e.g.*, Sherman Act Section 2 Joint Hearing: Refusals to Deal Session Hr’g Tr. 46, July 18, 2006 [hereinafter July 18 Hr’g Tr.] (Pate) (“[W]hile a general balancing test is flexible . . . it is inherently lacking in any objective content that businesses can apply in a predictable manner to make their decisions.”); Melamed, *supra* note 8, at 387 (stating that a “static market-wide balancing test” would “place a costly and often impossible burden on the defendant when deciding in real time how to conduct its business”).

B. Profit-Sacrifice and No-Economic-Sense Tests

Some commentators favor reducing the uncertainties, and thus perceived chilling effects, surrounding the application of an effects-balancing test by applying tests that do away with the need for that balancing altogether. The profit-sacrifice and no-economic-sense tests are two prominent examples. These tests are often discussed together and commentary is not always clear as to their precise definitions. Indeed, some appear to equate them, while others believe they are different. The Department does not consider them to be equivalent and sets forth below how these tests are sometimes described and how they differ.

Generally, a profit-sacrifice test asks whether the scrutinized conduct is more profitable in the short run than any other conduct the firm could have engaged in that did not have the same (or greater) exclusionary effects. If the conduct is not more profitable, the firm sacrificed short-run profits and might have been investing in an exclusionary scheme, seeking to secure monopoly power and recoup the foregone profits later.

One can apply a version of the no-economic-sense test in a similar fashion, comparing the non-exclusionary profits from the conduct to the profits the firm would have earned from alternative, legal conduct in which it would have engaged (the “but-for” scenario).⁴³ If the non-exclusionary profits are greater, the conduct would make economic sense without exclusionary effects and thus be legal; if the non-exclusionary profits are less, the conduct would not make economic sense and thus potentially be illegal.

However, as often described, another variation of the no-economic-sense test asks whether the conduct in question contributed any profit to the firm apart from its exclusionary effect. As long as the conduct is profitable apart from its exclusionary effect, it would pass this variation of the no-economic-sense test, regardless of whether any other

conduct would have been more profitable or the extent of any harm to competition.

The profit-sacrifice and no-economic-sense tests seek to establish objective standards by which to identify conduct that is likely to damage the competitive process, as opposed to merely aggressive competition. The tests draw on the Supreme Court’s predatory-pricing jurisprudence.⁴⁴ A cornerstone of those cases is a 1975 law review article by Professors Areeda and Turner, in which they argued that “predation in any meaningful sense cannot exist unless there is a temporary sacrifice of net revenues in the expectation of greater future gains.”⁴⁵

That concept, and subsequent academic commentary suggesting that an action’s likely economic effects are key to assessing liability under section 2,⁴⁶ played a significant role in several decisions construing section 2, including *Aspen Skiing*,⁴⁷ *Matsushita Industrial*

⁴⁴ *Id.* at 16–17.

⁴⁵ Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 698 (1975); see also *id.* (asserting that “the classically-feared case of predation has been the deliberate sacrifice of present revenues for the purpose of driving rivals out of the market and then recouping the losses through higher profits earned in the absence of competition”).

⁴⁶ See, e.g., ROBERT H. BORK, *THE ANTITRUST PARADOX* 144 (1978) (“Predation may be defined . . . as a firm’s deliberate aggression against one or more rivals through the employment of business practices that would not be considered profit maximizing except for the expectation either that (1) rivals will be driven from the market, leaving the predator with a market share sufficient to command monopoly profits, or (2) rivals will be chastened sufficiently to abandon competitive behavior the predator finds inconvenient or threatening.”); Janusz A. Ordover & Robert D. Willig, *An Economic Definition of Predation: Pricing and Product Innovation*, 91 YALE L.J. 8, 9–10 (1981) (“[P]redatory behavior is a response to a rival that sacrifices part of the profit that could be earned under competitive circumstances, were the rival to remain viable, in order to induce exit and gain consequent additional monopoly profit.”).

⁴⁷ *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 608 (1985) (noting that defendant “elected to forgo . . . short-term benefits because it was more interested in reducing competition in the Aspen market over the long run”).

⁴³ See Werden, *supra* note 35, 420–22.

Co., Ltd. v. Zenith Radio Corp.,⁴⁸ *Brooke Group*,⁴⁹ and several lower court decisions.⁵⁰ For instance, pricing below cost is an objectively measurable standard and indicates that the pricing makes no economic sense in the short term and, accordingly, is likely to be serving other ends, which might include exclusion of competitors. Similarly, the *Trinko* Court, while not expressly adopting the no-economic-sense test, identified the *Aspen Skiing* defendant's "willingness to forsake short-term profits to achieve an anticompetitive end" as a key element of the liability finding.⁵¹

Although, as discussed above, there are

⁴⁸ 475 U.S. 574, 588–89 (1986) (explaining that an "agreement to price below the competitive level requires the conspirators to forgo profits that free competition would offer them" in the hope of obtaining "later monopoly profits").

⁴⁹ 509 U.S. 209, 224 (1993) (holding that low prices are not illegal under section 2 absent "a dangerous probability[] of recouping [the] investment in below-cost prices").

⁵⁰ See, e.g., *Covad Commc'ns Co. v. Bell Atl. Corp.*, 398 F.3d 666, 675 (D.C. Cir. 2005) ("[I]n order to prevail upon [a refusal-to-deal] claim [plaintiff] will have to prove [defendant's] refusal to deal caused [defendant] short-term economic loss."); *Morris Commc'ns Corp. v. PGA Tour, Inc.*, 364 F.3d 1288, 1295 (11th Cir. 2004) ("[A]nticompetitive conduct . . . is conduct without a legitimate business purpose that makes sense only because it eliminates competition." (internal quotation marks omitted) (quoting *Gen. Indus. Corp. v. Hartz Mountain Corp.*, 810 F.2d 795, 804 (8th Circuit 1987))); *Neumann v. Reinforced Earth Co.*, 786 F.2d 424, 427 (D.C. Cir. 1986) ("[P]redation involves aggression against business rivals through the use of business practices that would not be considered profit maximizing except for the expectation that (1) actual rivals will be driven from the market, or the entry of potential rivals blocked or delayed, so that the predator will gain or retain a market share sufficient to command monopoly profits, or (2) rivals will be chastened sufficiently to abandon competitive behavior the predator finds threatening to its realization of monopoly profits."); *William Inglis & Sons Baking Co. v. ITT Cont'l Baking Co.*, 668 F.2d 1014, 1030–31 (9th Cir. 1981) (stating that, in order to violate section 2, conduct "must be such that its anticipated benefits were dependent upon its tendency to discipline or eliminate competition and thereby enhance the firm's long-term ability to reap the benefits of monopoly power").

⁵¹ *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 409 (2004).

variations on the profit-sacrifice and no-economic-sense tests, proponents of all variations maintain that the tests are consistent with the Supreme Court's long-standing emphasis on protecting the competitive process and avoiding the chilling of procompetitive conduct.⁵² For instance, while acknowledging that the tests have been "criticized by numerous commentators who are concerned that [they] will result in false negatives,"⁵³ one proponent nevertheless contends that the policy tradeoffs are justified:

The sacrifice test does not purport to condemn all conduct that might create market power or reduce economic welfare. Rather, the test rests on the judgment that market-wide balancing tests, which in theory could condemn all welfare-reducing conduct, will in practice prove to be an inferior legal standard because of their greater difficulty in administration and their perverse incentive effects.⁵⁴

Supporters of the tests also recommend them on grounds that firms can use them to assess the legality of proposed actions before acting and that courts should be able to apply them relatively easily.⁵⁵ Even supporters

⁵² See, e.g., ANTITRUST MODERNIZATION COMM'N, *supra* note 9, at 91–92; *General Approaches to Defining Abusive/Monopolistic Practices—Roundtable*, in 2006 ANNUAL PROCEEDINGS OF THE FORDHAM COMPETITION LAW INSTITUTE 577–79 (Barry E. Hawk ed., 2007) (Werden).

⁵³ A. Douglas Melamed, *Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal*, 20 BERKELEY TECH. L.J. 1247, 1257 (2005).

⁵⁴ *Id.*; see also Werden, *supra* note 35, at 433 ("The no economic sense test is predicated on the proposition that some potentially harmful conduct must be tolerated to avoid even greater harms from chilling risk taking and aggressively competitive conduct.").

⁵⁵ See Jan. 31 Hr'g Tr., *supra* note 10, at 135 (Rubinfeld) (asserting that the profit sacrifice test is "easier to operationalize"); July 18 Hr'g Tr., *supra* note 42, at 32 (Pate) (stating that "some variation of a price-cost comparison . . . is going to be necessary if objectivity is going to be brought to the inquiry"); Melamed, *supra* note 8, at 393 ("Perhaps most important, the sacrifice test provides simple, effective, and meaningful guidance to firms so that they will know how to avoid antitrust liability without steering clear of procompetitive conduct."); Werden, *supra* note 35, at 433.

acknowledge, however, that these tests can be difficult to apply in some circumstances, for instance “in cases involving simultaneous benefits for the defendant and cost increases for rivals.”⁵⁶

Some panelists criticized these tests for focusing only indirectly on consumers and preferred that section 2 be construed to focus directly on consumer welfare.⁵⁷ Other panelists made similar points, emphasizing the potential of these tests to result in false negatives, allowing conduct that harms consumers to escape liability under section 2.⁵⁸

The profit-sacrifice test also has been

⁵⁶ Melamed, *supra* note 53, at 1261; *see also* Werden, *supra* note 35, at 421 (“The utility of the no economic sense test ultimately is apt to vary, depending mainly on the feasibility of determining whether the challenged conduct would make no economic sense but for its tendency to eliminate competition. That determination should be feasible in the vast majority of cases, but it might not be if the conduct generates legitimate profits as well as profits from eliminating competition.”).

⁵⁷ *See, e.g.*, May 1 Hr’g Tr., *supra* note 9, at 67 (Kolasky) (stating that the profit-sacrifice test “focuses . . . too much attention on whether the conduct makes sense from the standpoint of the alleged monopolist as opposed to what is its effect on the consumer”); Sherman Act Section 2 Joint Hearing: Business Testimony Session Hr’g Tr. 35, Jan. 30, 2007 (Edlin).

⁵⁸ *See, e.g.*, May 1 Hr’g Tr., *supra* note 9, at 77 (Baker) (“If the profit sacrifice or no economic sense test differs from the reasonableness analysis, it is doing so in order . . . to put a thumb on the scales in favor of defendants.”); July 18 Hr’g Tr., *supra* note 42, at 25 (Pitofsky) (stating that he is “uncomfortable” with the profit-sacrifice test because it focuses on the monopolist rather than the consumer); *see also* Gavil, *supra* note 12, at 71 (“As an economic matter, ‘sacrifice’ is not relevant either to the defendant’s market power or the fact that its conduct resulted in actual exclusion or consumer harm.”); Jonathan M. Jacobson & Scott A. Sher, “No Economic Sense” Makes No Sense for Exclusive Dealing, 73 ANTITRUST L.J. 779, 786 (2006) (“[M]ost importantly, the no economic sense and profit sacrifice tests still do not ask the correct question – that is, whether the practice is likely to aid consumers or to hurt them.”); Salop, *supra* note 8, at 345–46, 357–63 (stating that the profit-sacrifice test is a highly imperfect and generally biased predictor of the impact of the conduct on competition and consumer welfare). *But see* Werden, *supra* note 35, at 428 (“Theoretical possibilities [of false negatives] should be given little weight in formulating antitrust policy or any other legal rules of general application.”).

criticized for its potential to result in false positives, condemning procompetitive investments and product innovation. Almost all substantial investments—from building a new factory to new-product development—involve a short-term sacrifice of current revenue in expectation of future increased revenues resulting from taking business from competitors. The test is criticized because it “does not adequately distinguish anticompetitive ‘sacrifice’ from procompetitive investment”⁵⁹ and may condemn clearly procompetitive conduct.⁶⁰ As one commentator

⁵⁹ Herbert Hovenkamp, Antitrust and the Dominant Firm: Where Do We Stand? 12 (n.d.) (unpublished manuscript), available at <http://www.ftc.gov/os/comments/section2hearings/hovenkamppaper.pdf> (“One particular problem with sacrifice tests is that most substantial investments involve a short term ‘sacrifice’ of dollars in anticipation of increased revenue at some future point. . . . Likewise, product innovations are always costly to the defendant, and their success may very well depend on their ability to exclude rivals from the market”); *cf.* Carl Shapiro, Exclusionary Conduct, Testimony Before the Antitrust Modernization Commission 4 (Sept. 29, 2005), available at http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Shapiro_Statement.pdf (endorsing a safe harbor for “investment in new and superior production capacity” and “unadorned product improvement” even though such investment could in theory deter entry by rivals or induce the exit of rivals, thereby leading to higher prices).

⁶⁰ *See, e.g.*, Jan. 31 Hr’g Tr., *supra* note 10, 113–14 (Gilbert) (“[A] profit sacrifice test . . . doesn’t . . . make any sense to innovation” because “innovation almost always involves a profit sacrifice” which is called “investing in research and development. . . . [Moreover], if [innovation] really works, [it] probably excludes competitors. . . . [P]roducing a really good mousetrap” means that “other mousetraps can’t compete.”); Elhauge, *supra* note 8, at 274 (noting that the sacrifice test fails for the fundamental reason that sacrificing short-term profits to make the sort of investments that enable one to destroy one’s rivals is ordinarily not a sign of evil but the mark of capitalist virtue); Popofsky, *supra* note 4, at 462 (noting that the profit-sacrifice test “could deem unlawful conduct that impedes rivals only because it improves the attractiveness of the defendant’s product and has no other exclusionary property”); Salop, *supra* note 8, at 314 (observing that “the profit-sacrifice standard may well be more likely to condemn a cost-reducing investment that leads to market power than would the consumer welfare effect standard”).

puts it,

[P]ublic policy should encourage firms that want to invest in activities that consumers value in order to gain future sales from their rivals. However, because such actions by definition reduce present profits, a blind application of a “profit sacrifice” test could condemn almost any competitive behavior. When a test could potentially challenge a wide array of core competitive behaviors, it becomes dangerous.⁶¹

In addition, although these tests are based in part on their purported ease of administration, critics claim that they are difficult to implement in practice.⁶² For instance, some critics maintain that the tests are inappropriate for analyzing exclusive-dealing arrangements, which make economic sense for the defendant “precisely because they lessen competition by rivals for the affected business.”⁶³ These critics contend that there is no practical way to separate the economic benefits to a defendant from the exclusionary impact on rivals.⁶⁴

⁶¹ Dennis W. Carlton, *Does Antitrust Need to Be Modernized?*, J. ECON. PERSP., Summer 2007, at 155, 170. *But see* Gregory J. Werden, *Identifying Single-Firm Exclusionary Conduct: From Vague Concepts to Administrable Rules*, in 2006 FORDHAM COMPETITION LAW INSTITUTE 509, 528 (Barry E. Hawk ed., 2007).

⁶² *See, e.g.*, May 1 Hr’g Tr., *supra* note 9, at 69 (Jacobson) (“[I]t is a very, very difficult test to administer.”); *id.* at 77 (Baker) (noting “tremendous problems with administrability”); Elhauge, *supra* note 8, at 293 (“The general problem is that the efforts to modify the profit-sacrifice test to avoid its substantive defects necessarily require distinguishing between profits earned desirably (even if it excludes rivals) and profits earned undesirably Not only does it beg the question of what the criteria of desirability are, it also eliminates any administrability benefit by converting the test from one based on actual profits to one based on the desirability of how those profits were acquired.”); Gavil, *supra* note 12, at 55 (contending that “all forms of the but-for test are objectionable on procedural grounds”); Salop, *supra* note 8, at 321, 323 & n.50 (noting that there is debate over the proper way to implement the standard, including what the benchmark should be and how to determine what profits are due to the lessening of competition compared with other causes).

⁶³ Sherman Act Section 2 Joint Hearing: Exclusive Dealing Session Hr’g Tr. 59, Nov. 15, 2006 (Jacobson).

⁶⁴ *See id.*; Jacobson & Sher, *supra* note 58, at 781

Another contends that these tests conflict with the sham-litigation doctrine; costly litigation might be permissible under the sham-litigation doctrine yet fail the no-economic-sense or profit-sacrifice tests.⁶⁵ Still others express concern that some misleading and deceptive conduct with no efficiency justification might involve little or no profit sacrifice.⁶⁶

Yet another potential problem with these tests is that they may open the door to plaintiffs hypothesizing any number of alternative courses of action that may, especially with the benefit of hindsight, have been more profitable for defendant. However, there may be legitimate reasons why a firm does not pursue the most profitable course of action, including simple unawareness of the options. No defendant should be required to show that it maximized profits among all conceivable choices. Hinging antitrust liability on such second guessing raises serious concerns that such a standard would undermine rather than promote the goal of economic growth and increased consumer welfare.

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 and should not be the test for section 2 liability.

The Department believes that a profit-sacrifice test should not be the test for section 2 liability.

The Department further concludes that the

(Analyzing exclusive dealing only under a no-economic-sense or profit-sacrifice test is “unintelligible” because “there is no way to separate the economic benefit to the defendant from the exclusionary impact on rivals. The relevant question for exclusive dealing is not whether it ‘makes economic sense’ (because it so frequently does), but whether, on balance, the specific arrangements at issue are likely to raise prices, reduce output, or otherwise harm consumers. The no economic sense test declines that inquiry.”).

⁶⁵ *See* Popofsky, *supra* note 4, at 463.

⁶⁶ *See, e.g.*, Susan A. Creighton et al., *Cheap Exclusion*, 72 ANTITRUST L.J. 975, 985–86 (2005). *But see* Werden, *supra* note 35, at 425–26.

no-economic-sense test should not be the exclusive test for section 2 liability. As even its proponents recognize, there are difficulties using it in all circumstances. Assessing what portion of an act's anticipated profits is exclusionary, as opposed to non-exclusionary, is apt to be difficult in many cases. Also, the test arguably does not work well for exclusionary conduct involving little cost to defendant. The Department also agrees with those who are concerned that this test might allow businesses too much freedom to engage in conduct likely to harm competition, because conduct could be protected even if it contributed virtually no profits (for example, only \$1 of profit) apart from its exclusionary effect but caused tremendous harm to the competitive process. And to the extent that the test relies on a comparison to a but-for scenario, there may be situations where the but-for scenario either is not clear or would take much effort to establish.

Although the Department does not recommend the no-economic-sense test as a necessary condition for liability in all section 2 cases, it believes that the test may sometimes be useful in identifying certain exclusionary conduct.⁶⁷ The test can also serve as a valuable counseling tool by highlighting the need for businesses to think carefully about why they are pursuing a particular course of conduct. If conduct does not make economic sense at the time it is undertaken except for its exclusionary effect on competition, it likely will be difficult to defend.⁶⁸

⁶⁷ See Werden, *supra* note 35, at 418.

⁶⁸ See, e.g., May 1 Hr'g Tr., *supra* note 9, at 55 (McDavid) ("[A]s someone who does not think there is a single standard, I do think [profit sacrifice] is [an] appropriate test, but I do not think it is *the* appropriate test." (emphasis added)); *id.* at 64 (Calkins) ("Everybody . . . would agree that the no economic sense question is a good [one]" for an attorney to ask a client, but it is not the only question.); *id.* at 63–64 (Willig) (stating that the no-economic-sense test is another way of asking whether there is a sound business rationale for the conduct); *id.* at 66 (Kolasky) (agreeing that "focusing on profit sacrifice and whether the conduct makes economic sense is . . . a very useful question to ask your clients"); Nov. 29 Hr'g Tr., *supra* note 17, at 202 (Crane) (stating that the no-economic-

Although the Department does not recommend the no-economic-sense test as a necessary condition for liability in all section 2 cases, it believes that the test may sometimes be useful in identifying certain exclusionary conduct.

C. Equally Efficient Competitor Test

The equally efficient competitor test addresses some of the concerns with open-ended balancing by requiring that "the challenged practice is likely in the circumstances to exclude from defendant's market an equally or more efficient competitor."⁶⁹ If a plaintiff makes such a showing, "defendant can rebut by proving that although it is a monopolist and the challenged practice exclusionary, the practice is, on balance, efficient."⁷⁰ This test is based on the rationale "that a firm should not be penalized for having lower costs than its rivals and pricing accordingly."⁷¹

The equally efficient competitor test also draws on principles similar to those underlying the Supreme Court's predatory-pricing jurisprudence, under which a price is deemed predatory only if it is reasonably calculated to exclude a rival that is at least as efficient as the defendant. As Judge Posner explains, "It would be absurd to require the firm to hold a price umbrella over less efficient entrants. . . . [P]ractices that will exclude only less efficient firms, such as the monopolist's dropping his price nearer to (but not below) his cost, are not actionable, because we want to encourage efficiency."⁷² Courts have referred to the

sense test presents difficulties as a starting point but it makes some sense as a defense); Hovenkamp, *supra* note 59, at 13 (stating that the no-economic-sense test offers a good deal of insight into the question of when aggressive actions by a single firm go too far, but it can lead to erroneous results unless complicating qualifications are added).

⁶⁹ RICHARD A. POSNER, *ANTITRUST LAW* 194–95 (2d ed. 2001).

⁷⁰ *Id.* at 195.

⁷¹ Herbert Hovenkamp, *Exclusion and the Sherman Act*, 72 U. CHI. L. REV. 147, 154 (2005).

⁷² POSNER, *supra* note 69, at 196.

concept of an equally efficient competitor in a number of cases involving predatory pricing and bundled discounts.⁷³

Proponents of this test point out that it is designed to allow firms to take full advantage of their efficiency and protects competition offered by efficient rivals. Moreover, it is useful because it allows firms to assess their conduct at the outset based on something they should be able to evaluate—their own costs.⁷⁴

Critics of the test assert that there are a number of problems with it, however. First, they challenge the basic premise of the test—that section 2 should focus only on the exclusion of competitors as efficient as the alleged monopolist. They contend that “entry [by] even a less efficient rival can stimulate competition and lower prices if an incumbent dominant firm is charging monopoly prices.”⁷⁵

⁷³ See, e.g., *LePage’s Inc. v. 3M*, 324 F.3d 141, 155 (3d Cir. 2003) (en banc) (observing that “even an equally efficient rival may find it impossible to compensate for lost discounts on products that it does not produce” (quoting *AREEDA & HOVENKAMP*, *supra* note 2, ¶ 749, at 83–84 (Supp. 2002))); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1063 (8th Cir. 2000) (stating that above-cost market-share discounts were not unlawful where evidence showed customers switched to competitors offering better discounts); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 232 (1st Cir. 1983) (Breyer, J.) (noting that, if a firm prices below “avoidable” or “incremental” cost, equally efficient competitors cannot permanently match the price and stay in business); *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 466 (S.D.N.Y. 1996) (“[B]elow-cost pricing, unlike pricing at or above that level, carries with it the threat that the party so engaged will drive equally efficient competitors out of business, thus setting the stage for recoupment at the expense of consumers.”).

⁷⁴ See Sept. 12 Hr’g Tr., *supra* note 9, at 14–15 (Lowe) (acknowledging that efficient competitor is not the only test that can be used and that there may be more than one test applicable to any particular case, but that it is a useful principle because it allows dominant firms to assess their conduct based on their own costs).

⁷⁵ Gavil, *supra* note 12, at 59; see also, e.g., June 22 Hr’g Tr., *supra* note 28, at 124 (Brennan) (noting that “inefficient competitors hold down price”); Salop, *supra* note 8, at 328 (“The fundamental problem with applying the equally efficient entrant standard . . . is that the unencumbered (potential) entry of less-efficient competitors often raises consumer welfare.”).

These critics contend that this is especially true in the case of nascent competition where an equally efficient competitor standard “could lead to false negatives . . . and pose a significant threat of under-deterrence.”⁷⁶ In markets where competition is just starting to emerge, they contend, it is inappropriate to compare the efficiency of new rivals with that of the monopolist.

Second, the test has also been criticized as difficult to administer. Exactly what constitutes an equally efficient competitor is not always evident, and the test is especially difficult to apply outside the pricing context.⁷⁷ For example, it is not clear whether a firm that produces a single product as efficiently as a defendant in a tying case would qualify as an equally efficient competitor if it does not produce the other product(s) involved in the tie. In the multi-product setting, a firm may be equally efficient with respect to one product but not with respect to all the products. A diversified firm may enjoy superior efficiencies in joint production and marketing, as compared to a firm that is arguably as efficient with respect to the one target product. Thus, it may be difficult to conclude that a firm would be equally efficient based on the analysis of only the one targeted product. Moreover, it is difficult to measure and compare efficiencies in multi-product cases where there are joint costs. Similarly, the concept of an equally efficient competitor may be difficult to apply in the exclusive-dealing context, where a firm’s efficiency may depend on how it distributes its products.

The Department believes that whether conduct has the potential to exclude, eliminate,

⁷⁶ Gavil, *supra* note 12, at 61; see also June 22 Hr’g Tr., *supra* note 28, at 73 (Bolton) (expressing concern over exclusion of entrants that offer nascent competition); Gavil, *supra* note 12, at 59–61; Hovenkamp, *supra* note 71, at 154.

⁷⁷ See Nov. 29 Hr’g Tr., *supra* note 17, at 140–41 (Ordoover) (observing that “what it means to be an equally efficient competitor is subject to debate”); Melamed, *supra* note 8, at 388 (“[I]t is not clear what it means to exclude only a less-efficient rival, especially when firms and products are heterogenous.”); *infra* Chapter 6, Part I(C).

or weaken the competitiveness of equally efficient competitors can be a useful inquiry and may be best suited to particular pricing practices.⁷⁸ The Department does not believe that this inquiry leads readily to administrable rules in other contexts, such as tying and exclusive dealing.

Whether conduct has the potential to exclude, eliminate, or weaken the competitiveness of equally efficient competitors can be a useful inquiry and may be best suited to particular pricing practices.

D. Disproportionality Test

In their *Trinko* merits brief, the Department and the FTC advised the Supreme Court that, in the absence of a conduct-specific rule, conduct is anticompetitive under section 2 when it results in “harm to competition” that is “disproportionate to consumer benefits (by providing a superior product, for example) and to the economic benefits to the defendant (aside from benefits that accrue from diminished competition).”⁷⁹ Under the disproportionality test, conduct that potentially has both procompetitive and anticompetitive effects is anticompetitive under section 2 if its likely anticompetitive harms substantially outweigh its likely procompetitive benefits.

⁷⁸ See Hovenkamp, *supra* note 71, at 153 (stating that “[t]he ‘equally efficient rival’ test has found widespread acceptance in predatory pricing cases”); see also, e.g., *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993) (identifying the relative “cost structure” of competitors as a source of the safe harbor for above-cost pricing in predatory-pricing cases); *Areeda & Turner*, *supra* note 45, at 709–18, 733 (recognizing that, in the predatory-pricing context, prices at or above average variable cost exclude less efficient firms while minimizing the likelihood of excluding equally efficient firms).

⁷⁹ Brief for the United States & the Federal Trade Commission as Amici Curiae Supporting Petitioner at 14, *Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (No. 02-682), available at <http://www.usdoj.gov/atr/cases/f201000/201048.htm>. In the brief, the Department and the FTC also argued that the no-economic-sense test should apply to the specific conduct at issue—a refusal to deal.

Properly applied, the disproportionality test reduces the need to precisely balance procompetitive and anticompetitive effects, which, as described above, is a difficult and costly task. In addition, it allows firms the freedom to compete vigorously without undue fear of antitrust liability based on an after-the-fact determination that their conduct had small negative effects on static competition. The disproportionality test reduces the risks of chilling procompetitive conduct but prohibits conduct that will significantly harm competition and consumer welfare.

The justification for this test arises from the principles discussed in chapter 1. It expressly focuses on prohibiting conduct that harms competition, not just individual competitors. It seeks to provide reasonable clarity for firms over a wide range of activity. It seeks to reduce administrative costs. Further, it recognizes that the cost of legal rules that erroneously condemn procompetitive conduct likely will be higher and more persistent than the cost of rules that erroneously exonerate anticompetitive conduct.

To be sure, the disproportionality test is not without its difficulties and may not be easy to apply in some instances. As the enforcement agencies acknowledged in their *Trinko* brief, applying the test “‘can be difficult,’ because ‘the means of illicit exclusion, like the means of legitimate competition, are myriad.’”⁸⁰

Moreover, as one commentator cautions, disproportionality “is hardly an inherently certain formula.”⁸¹ In the most difficult cases—those involving significant harm and smaller, but still significant, efficiencies—there is some ambiguity. As one commentator queries, “Is 55–45 percent ‘disproportionate’ enough? Or do proponents of the test think 75–25 percent is more what they have in mind.”⁸²

⁸⁰ *Id.* at 14 (quoting *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001) (en banc) (per curiam)).

⁸¹ Gavil, *supra* note 12, at 64.

⁸² *Id.*; see also Herbert Hovenkamp, *Signposts of Anticompetitive Exclusion: Restraints on Innovation and Economies of Scale*, in 2006 FORDHAM COMPETITION LAW INSTITUTE 409, 412 (Barry E. Hawk ed., 2007) (acknowledging that “phrases such as ‘disproportionate to the resulting benefits’ are marshmallows, covering

This issue is critical. Failure to ensure that courts condemn only conduct that has an adverse effect on competition that is substantially disproportionate to any benefits could render this test tantamount to the burdensome, open-ended effects-balancing test discussed above.

Importantly, the standard likely can be readily applied in a number of cases because either the harm or the benefit is clearly predominant.⁸³ A trivial benefit should not outweigh substantial anticompetitive effects. At the same time, if the benefits and harms are comparable or close to comparable, then the conduct should be lawful under this test.

The Department recognizes that the disproportionality test imposes a higher burden on a plaintiff than the effects-balancing test. If there is procompetitive justification for the challenged conduct, the test requires the plaintiff to demonstrate that the harm to competition substantially outweighs the benefits. The Department believes that this higher liability threshold is in keeping with the Supreme Court's repeated insistence that section 2 should not be construed in a way that chills procompetitive conduct, yet it also prohibits conduct where significant anticompetitive harm appears likely.

At the same time, as Professor Hovenkamp states in endorsing this test, its "formulation is not intended to give a complete definition of" conduct that is anticompetitive under section 2, but rather is "only a starting point for the development of specific rules for specific types of conduct."⁸⁴ The Department believes that conduct-specific tests and, where appropriate, safe harbors enable more effective enforcement while providing businesses with greater

very much or very little depending on one's ideology or fundamental beliefs").

⁸³ See Gavil, *supra* note 12, at 77 ("[M]ost cases will be weeded out before trial for weaknesses related to the plaintiff's assertions with respect to monopoly power or effects. To the extent a small number of cases proceed any further, most will be decided based on lopsided evidence—lots of harm and little or no efficiency, or little harm and substantial efficiency.").

⁸⁴ Hovenkamp, *supra* note 82, at 412.

certainty, are most administrable by the agencies and courts, and reduce the risk of erroneous determinations. Conduct-specific tests are particularly important because, as Professor Hovenkamp notes, "our level of concern and our administrative capabilities vary considerably among the list of practices that antitrust tribunals have identified as exclusionary."⁸⁵ The Department, therefore, will continue to work to develop conduct-specific tests and safe harbors. However, in general, the Department believes that, when a conduct-specific test is not applicable, the disproportionality test is likely the most appropriate test identified to date for evaluating conduct under section 2.

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IV. Conclusion

There was no consensus at the hearings, and there is currently no consensus among commentators, that a single test should be used to define anticompetitive conduct for purposes of section 2. Although many of the proposed tests have virtues, they also have flaws. The Department believes that none currently works well in all situations.

Thus, as will be seen in subsequent chapters, the Department believes different types of conduct warrant different tests, depending upon, among other things, the scope of harm implicated by the practice; the relative costs of false positives, false negatives, and enforcement; the ease of application; and other administrability concerns. An important goal for any test is to identify conduct that harms competition while enabling firms effectively to evaluate the legality of their conduct before it is undertaken.

⁸⁵ *Id.*

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In deciding individual cases, courts would be well served to consider the appropriate allocation of burdens of proof and production. In applying legal standards, courts should determine whether the conduct at issue warrants employing a conduct-specific test. In general, the Department believes that when a conduct-specific test is not utilized, the disproportionality test is likely the most appropriate test identified to date for evaluating conduct under section 2.

Adopting conduct-specific tests is in keeping with modern Supreme Court section 2 jurisprudence. In the last twenty-five years, the Court has adopted conduct-specific tests for both predatory pricing and predatory bidding and has avoided articulating a general test applicable to all section 2 cases. Instead, the Court has set forth unifying principles— including protecting the competitive process and avoiding chilling procompetitive conduct— from which conduct-specific tests can be derived. The Department believes that the Court’s approach is appropriate and recommends further development of conduct-specific tests to guide the continued evolution of section 2 jurisprudence.