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GENERAL STANDARDS FOR EXCLUSIONARY CONDUCT

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I. Introduction

It is well-established that a firm with monopoly power violates section 2 only by engaging in "anticompetitive conduct."[1] Although many different kinds of conduct have been found to violate section 2, "[d]efining the contours of this element . . . has been one of the most vexing questions in antitrust law."[2]

The basic challenge lies in distinguishing between aggressive competition and anticompetitive, exclusionary conduct. As the U.S. Court of Appeals for the District of Columbia Circuit explained in *Microsoft*,[3]

> Whether any particular act of a monopolist is exclusionary, rather than merely a form of vigorous competition, can be difficult to discern: the means of illicit exclusion, like the means of legitimate competition, are myriad. The challenge for an antitrust court lies in stating a general rule for distinguishing between exclusionary acts, which reduce social welfare, and competitive acts, which

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* The views expressed are those of the author and Policy Studies' staff and do not necessarily reflect the views of the Commission or any individual Commissioner. The paper derives from early drafts developed in the context of the FTC/Department of Justice Joint Hearings on Section 2 of the Sherman Act: Single-Firm Conduct as Related to Competition. Any language that overlaps with other commentaries on the hearings reflects its origin in the common drafts.

1 Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004) (emphasis omitted) ("To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive *conduct.*").

2 1 ABA SECTION OF ANTITRUST LAW, AM. BAR ASS'N, ANTITRUST LAW D 241 (6th ed. 2007); *see also* ANTITRUST MODERNIZATION COMM'N, REPORT AND R

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

increase it.[4]

The *Microsoft* court adopted a "rule of reason" framework similar to that used in section 1 cases as that "general rule."[5] A number of commentators, however, have criticized the rule of reason approach, and proposed other types of unitary tests which they contend are more objective and administrable, both for the courts and for businesses.[6] Others have urged that specific tests[7] or safe harbors[8] be developed for particular types of conduct. As one panelist colorfully put it, "[T]here is a holy war raging over the appropriate liability standard under

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4 *Id.* at 58.

5 *Id.* at 58–59.

6 *See* Einer Elhauge, *Defining Better Monopolization Standard*s, 56 STAN. L. REV. 253, 330 (2003) (advocating rules of per se legality and illegality based on whether the sole effect of the conduct is to improve the monopolist's efficiency); Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2: The "No Economic Sense" Test*, 73 ANTITRUST L. J. 413 (2006) (advocating the no-economic-sense test); A. Douglas Melamed, *Exclusive Dealing Agreements and Other Exclusionary Conduct–Are There Unifying Principles*?, 73 ANTITRUST L.J. 375, 403 (2006) (advocating the sacrifice test); Mark R. Patterson, *The Sacrifice of Profits in Non-Price Predation*, 18 ANTITRUST 37, 43 (Fall 2003) (stating that "the sacrifice-of-profits test provides a desirable approach both for litigation and business planning"); *see also* Kenneth L. Glazer & Brian R. Henry, *Coercive vs. Incentivizing Conduct: A Way Out of the Section 2 Impasse?*, ANTITRUST, Fall 2008, at 45, 51 (proposing "a framework for analyzing vertical monopolization cases based on whether the conduct at issue is coercive or incentivizing"); Dennis W. Carlton & Ken Heyer, *Appropriate Antitrust Policy Towards Single-Firm Conduct: Extraction vs. Extension*, ANTITRUST, Summer 2008, at 50, 55 (proposing "that antitrust distinguish between conduct that is purely extractive" and "conduct that enables a firm to extend its market power by rendering its rivals' competitive restraints less effective . . . .").

7 *See* Mark S. Popofsky, *Defining Exclusionary Conduct: Section 2, The Rule of Reason, and the Unifying Principle Underlying Antitrust Rules*, 73 ANTITRUST L. J. 435, 466, 481 (2006) (contending that "Section 2 is not 'one size fits all'" and urging the courts to adopt "a manageable set of baseline legal tests that presumptively apply" to particular types of conduct). *But cf.* Melamed, *supra* note 6, at 384 (arguing that different rules for different types of conduct "would be problematic in practice" since "different rules . . . would inevitably invite disputes about how the conduct at issue should be categorized").

8 *See* Sherman Act Section 2 Joint Hearing: Business Testimony Hr'g Tr. 95–96, Feb. 13, 2007 (Stern); Sherman Act Section 2 Joint Hearing: International Issues Hr'g Tr. 130 [hereinafter Sept. 12 Hr'g Tr.] (Rill).

section 2 generally."[9]

These differing opinions reflect, in part, different views regarding the expected costs of "false positives" (cases in which liability is imposed on conduct that is procompetitive) and "false negatives" (cases in which liability is not imposed on conduct that is anticompetitive). If the standards used to assess legality generate significant false positives, beneficial, procompetitive business conduct may be chilled. At the same time, if they generate false negatives, consumers may be hurt by harmful conduct that escapes liability.

This paper first examines the development of section 2 conduct standards in the courts, focusing primarily on Supreme Court precedent. It then describes and analyzes the leading tests that commentators have proposed or endorsed for evaluating conduct under section 2, namely: (1) the *Microsoft* ***rule-of-reason*** framework, which examines both anticompetitive effects and procompetitive justifications within a structured, burden-shifting framework, and a variant, the ***disproportionality*** test, under which conduct that creates or maintains monopoly power is condemned only if it produces harms disproportionate to the resulting benefits; (2) the ***no-economic-sense*** and ***profit-sacrifice tests***, which focus on whether the challenged conduct made economic sense for the monopolist but for its potential exclusionary effect; (3) the ***equally-efficient-competitor*** test, which focuses on whether the challenged conduct would exclude an equally efficient rival; and (4) the ***impairing-rivals'-efficiencies*** test, which focuses on whether the suspect conduct solely created efficiencies for the monopolist or whether it also impaired the efficiencies of rivals.

The paper concludes that, while the proposed unitary tests are all useful for certain purposes, none can be used as a single bright-line rule for all of the many types of conduct subject to scrutiny under section 2, and that the *Microsoft* rule-of-reason framework should be utilized as the basic approach for analyzing the legality of single-firm conduct under section 2 of the Sherman Act.

II. Background: The Courts' Search for a Workable Conduct Standard

A. The Early Supreme Court Cases: From *Standard Oil* to *Grinnell*

Nearly a century ago, the Supreme Court in *Standard Oil* decided that the Sherman Act does not include "any direct prohibition against monopolization in the concrete,"[10] and concluded that the criterion to be used in determining whether particular conduct violated

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[9] Sherman Act Section 2 Joint Hearing: Tying Hr'g Tr. 59, Nov. 1, 2006 (Popofsky); *see also* Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 ANTITRUST L. J. 311–312 (2006) ("There is currently great intellectual ferment over the proper antitrust liability standard governing allegedly exclusionary conduct under Section 2 in the United States and Article 82 in Europe.").

[10] Standard Oil Co. v. United States, 221 U.S. 1, 62 (1911).

section 2 as well as section 1 is "the rule of reason."[11] The Supreme Court subsequently decided a number of monopolization cases but did not further elucidate how the "rule of reason" was to

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11 *Id*.

12 *See generally* 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶ 605–10 (3d ed. 2008) (discussing early monopolization cases).

13 United States v. Aluminum Co. of Am. (*Alcoa*), 148 F.2d 416 (2d Cir. 1945).

14 *Id.* at 429.

15 *Id.* at 430.

16 *Id*. at 431.

17 *Id.*

[18] *See, e.g.,*

[22] Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984). Otter Tail Power

defendant/monopolist's business justifications in determining whether its conduct was unlawful. In denying Kodak's motion for summary judgment, the Court stated that "[l]iability turns . . . on whether 'valid business reasons' can explain Kodak's actions,"[34] and concluded that factual questions about the validity and sufficiency of the justifications offered by Kodak precluded summary judgment.

Aspen Skiing and *Kodak* together established that the existence or lack of legitimate business justifications, defined in terms of efficiencies, is a principal factor affecting the legality of conduct challenged under Section 2.[35] However, as discussed below, some have questioned the administrability of this approach, and there is a further question whether an efficiency justification represents an "all-or-nothing proposition" where "the case is over" if there is a legitimate efficiency justification, or whether the efficiency justification must then be balanced against the anticompetitive effects.[36]

Kodak, decided over fifteen years ago, is the last section 2 case in which the Supreme Court has ruled for the plaintiff. The Supreme Court's post-*Kodak* decisions have articulated a demanding new test for certain types of pricing conduct, and have also stressed the importance

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create a second monopoly in services. The jury entered a verdict for the plaintiff, and the Ninth Circuit affirmed. Although it concluded that when a legitimate business justification supports the impugned conduct, there can be no section 2 violation, it found that there was sufficient evidence that Kodak's justifications were pretextual and therefore upheld the jury verdict. *See* Image Technical Servs. v. Eastman Kodak Co., 125 F.3d 1195, 1201, 1212–14, 1219–20 (9th Cir. 1997).

[34] *Kodak*, 504 U.S. at 483.

[35] ABA Section of Antitrust Law, *supra* note 2, at 243–44 ("One of the most important factors in determining whether the challenged conduct is to be condemned is a defendant's proffered business justifications, together with its significance or magnitude, its relation to the specific conduct in question, and the availability of less restrictive means to achieve the same goals.").

[36] *See* Kauper, *supra* note 21, at 1625 & n.18 (contending that *Aspen* and *Kodak* envision an "all or nothing proposition" and that neither decision envisions balancing the adverse effects of exclusion against efficiency gains).

[37] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

[38] *Id.* at 224.

[39] *Id.* at 226 (citations omitted).

[40] *Id.* at 223.

[41] *See, e.g.*, Gavil, *supra* note 21, at 16–17 ("Although the

"sharper focus" provided by the no-economic-sense test.[49] Additionally, the Agencies proposed that in other cases, in the absence of a conduct-specific rule, a disproportionality standard be employed. Under that standard, conduct would be deemed anticompetitive under section 2 when it results in "harm to competition" that is "disproportionate to consumer benefits (in terms of providing a superior product, for example) and to the economic benefits to the defendant (aside from benefits that accrue from diminished competition").[50]

The Court held for Verizon. It characterized *Aspen Skiing* as an exception to a general no-duty-to-deal rule, resting "at or near the outer boundary of § 2 liability,"[51] and distinguished that case on the ground that it involved both a profit sacrifice and termination of a prior voluntary course of dealing with a rival. Perhaps more importantly, the Court also emphasized that Verizon's conduct, unlike that at issue in *Aspen Skiing*, was subject to detailed regulatory control:

> One factor of particular importance is the existence of a regulatory structure designed to deter and remedy competitive harm. . . . Just as regulatory context may in other cases serve as a basis for implied immunity . . . it may also be a consideration in deciding whether to recognize an expansion of the contours of § 2.[52]

The Court did not adopt the profit-sacrifice/no-economic-sense test as the Agencies had urged. Nor did it address their disproportionality standard or clearly establish any alternative test governing unilateral refusals to deal with rivals or single-firm conduct more generally.[53] Indeed, the Court did not take issue with *Aspen's* formulations of the governing standards. In *dicta*, however, the Court articulated some of the same concerns with false positives, administrability issues, and institutional limitations that the Agencies had emphasized in their brief. Thus, the Court explained,

> Against the slight benefits of antitrust intervention here, we must weigh a realistic

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49 *Id.* at 15 ("Where, as here, the plaintiff asserts that the defendant was under a duty *to assist a rival*, the inquiry into whether conduct is 'exclusionary' or 'predatory' requires a sharper focus. In that context, conduct is not exclusionary or predatory *unless* it would make no economic sense for the defendant but for its tendency to eliminate or lessen competition.").

50 *Id.* at 14.

51 *Trinko*, 540 U.S. at 409.

52 *Id.* at 412.

53 *See* Kauper, *supra* note 21, at 1628 (suggesting that "it will be difficult to move the Court to articulate and follow standards of more general applicability").

6. *Weyerhaeuser*: Extension of the *Brooke Group* Test to Predatory Bidding

In its most recent decision pertaining to section 2 standards, the Court in *Weyerhaeuser* [60] concluded that predatory pricing and predatory bidding claims are similar and therefore extended *Brooke Group's* two-pronged predatory-pricing test to

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60 Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069 (2007).

61 *Id.* at 1077.

62 *Id.* at 1078 (citations omitted).

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

64 *See* Plaintiffs' Joint Proposed Conclusions of Law at 27, *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30 (D.D.C. 2000) ("These actions . . . made no business sense for Microsoft except as a means of removing [Netscape] Navigator as a platform threat and thereby protecting the Windows monopoly.").

challenged conduct.[65]

On appeal, however, the D.C. Circuit adopted and used a rule-of-reason framework. Under that framework, the plaintiff must first establish a *prima facie* case by showing that the challenged conduct had or was likely to have an adverse effect on competition. This means that the challenged conduct must "harm the competitive *process* and thereby harm consumers. In contrast, harm to one or more *competitors* will not suffice."[66] The defendant may counter by establishing a procompetitive justification for its conduct. Plaintiff then must either rebut defendant's showing or, if it does not, demonstrate that the anticompetitive harm outweighs the procompetitive benefit.[67] As the court observed, this framework is similar to the rule of reason long applied in evaluating conduct under section 1.[68]

In evaluating Microsoft's conduct using this approach, the Court of Appeals systematically examined each of the many types of conduct the plaintiffs alleged to be anticompetitive, asking first whether the plaintiffs had met their burden of showing anticompetitive effect, and, if so, whether Microsoft had offered a non-pretextual procompetitive e

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65 *United States v. Microsoft Corp.,* 87 F. Supp. 2d 30, 44 (D.D.C. 2000) (ruling that "[b]ecause Microsoft's business practices 'would not be considered profit maximizing except for the expectation that . . . the entry of potential rivals' . . . will be 'blocked or delayed,'" Microsoft's actions must be deemed predatory).

66 *Microsoft*, 253 F.3d at 58 (emphasis in original).

67 *Id.* at 59.

68 *Id.* ("In cases arising under §1 of the Sherman Act, the courts routinely apply a similar balancing approach under the rubric 'rule of reason'. . . . [In *Standard Oil*] . . . the Supreme Court used that term to describe the proper inquiry under both sections of the Act. . . . As the Fifth Circuit more recently explained, 'it is clear . . . that the analysis under Section 2 is similar to that under Section 1 regardless [of] whether the rule of reason label is applied . . . .'") (citations omitted).

69 *See id.* at 60–78.

[70] *See id.* at 63, 67–68, 71, 74–75.

[71] *See id.* at 63 ("We agree that a shell that automatically prevents the Windows desktop from ever being seen by the user is a drastic alteration of Microsoft's copyrighted work, and outweighs the marginal anticompetitive effect of prohibiting the OEMs from substituting a different interface automatically upon completion of the initial boot process.").

[72] *See, e.g.*, Sherman Act Section 2 Joint Hearing: Concluding Session Hr'g Tr. 15–16, May 8, 2007 [hereinafter May 8 Hr'g Tr.] (Pitofsky) (defining key question as whether to adopt a rule-of-reason balancing test or a unitary profit-sacrifice test, and expressing strong support for the rule of reason); *id.*

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[81] *See* Melamed, *supra*

in any event, the sacrifice tests (discussed below) are more difficult to apply.[86] Furthermore, say

[86] *See* Salop, *supra* note 9, at 351–52 ("[T]hat same judicial competence argument would apply just as strongly to the implementation of the profit sacrifice test, which requires a court to evaluate profitability in an unrealistic, hypothetical world."); Jonathan M. Jacobson & Scott A. Sher, *"No Economic Sense" Makes No Sense For Exclusive Dealing*, 73 ANTITRUST L.J. 779, 801 (2006) ("[The] application of traditional rule of reason analysis is a good deal *less* complicated [than the no economic sense test].").

[87] *See* Salop, *supra* note 9, at 351 ("[C]riticism[s] involv[ing] judicial competence . . . seem extreme and unreliable. The rule of reason has been used in Section 1 and Section 7 cases, so it is not clear why Section 2 would be so much harder."); July 18 Hr'g Tr. at 91 (Salop) ("[B]alancing tests all over the law. All over the place. And a generalized criticism that courts aren't good at balancing, well, that's pretty much what courts do."); *id.* at 24 (Pitofsky) ("[W]ho are the judges deciding joint venture cases? Merger cases? Rule of reason cases? . . . [T]hey all involve generalist judges. Up until now, I thought U.S. antitrust was doing a pretty good job . . . .").

> of the defendant. But we reemphasize, as *Microsoft* suggests, that cases involving (a) a truly exclusionary practice, (b) offset by a compelling efficiency explanation, and (c) with no less restrictive alternative will be uncommon.[88]

On the other hand, if one defines "disproportionality" to require the plaintiff to show that the challenged practice has anticompetitive effects that are substantially disproportionate to any

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88 3 AREEDA & HOVENKAMP, *supra* note 12, ¶ 651e3, at 122 (citation omitted).

89 Herbert Hovenkamp, *Antitrust and the Dominant Firm: Where Do We Stand?* 11, http://www.ftc.gov/os/comments/section2hearings/hovenkamppaper.pdf.

90 *See, e.g.*, Melamed, *supra* note 6, at 389–91 (discussing different formulations of the profit-sacrifice test); ANTITRUST MODERNIZATION COMM'N, *supra* note 2, at 92 (same); Jan. 31 Hr'g Tr. at 29 (Edlin) (same).

91 *See, e.g.*, Popofsky, *supra* note 7, at 443 (profit-sacrifice test is sometimes articulated as the no-economic-sense test); Sherman Act Section 2 Joint Hearing: Predatory Pricing

part to address some of the perceived shortcomings of the sacrifice test.[92] Under the no-economic-sense standard, conduct would not be condemned "unless it would make no economic sense for the defendant but for its tendency to eliminate or lessen competition."[93] As long as the conduct (apart from its exclusionary effect) contributes to the firm's profits, it would satisfy the no-economic-sense test.[94]

The Department of Justice has advocated using the no-economic-sense test in a number of its recent section 2 cases,[95] and both Agencies urged in *Trinko* that it be adopted for cases involving alleged refusals to assist a rival. To date, however, it has not won acceptance in the courts.[96]

The sacrifice tests are based largely on the Supreme Court's predatory pricing jurisprudence, the cornerstone of which is a landmark law review article in which Professors Areeda and Turner explained that "predation in any meaningful sense cannot exist unless there is a temporary sacrifice of net revenues in the expectation of future gains."[97] That concept has played a significant role in a number of judicial decisions construing section 2, including *Aspen Skiing*[98] and *Brooke Group*.[99] And the *Trinko* Court, while not adopting the test, did emphasize

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Hr'g Tr. 122, June 22, 2006 [hereinafter June 22 Hr'g Tr.] (Brennan) (noting that the profit-sacrifice and no business sense tests "are equivalent, if one assumes that 'business sense' means 'maximize profits'").

92 *See* Werden, *supra* note 6, at 424.

93 *See Trinko* Brief, *supra* note 48, at 15.

94 *See* Werden, *supra* note 6, at 416, 420.

95 *Id.* at 413–14.

96 ANTITRUST MODERNIZATION COMM'N, *supra* note 2, at 91 ("Although DOJ has advanced this [no-economic-sense] test in several cases . . . no court has ever adopted it").

97 Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 698 (1975).

98 Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 475 U.S. 585, 608 (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 by harming its smaller competitor").

99 Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993). However, the sacrifice test is not identical to the *Brooke Group* test. *See* Salop, *supra* note 9, at 326 ("*Brooke Group* does not use a true profit-sacrifice standard but rather a negative-profit standard.").

the importance of the *Aspen Skiing* defendant's "willingness to forsake short-term profits to achieve an anticompetitive end" as a key element of the liability finding in that case.[100]

Although the sacrifice tests have been broadly recognized as helpful to the analysis of certain types of single-firm conduct, such as predatory pricing and refusals to deal with rivals, contentions that the tests should supplant a rule-of-reason analysis for assessing a wide range of single-firm conduct are more controversial.[101] In part, this reflects concern with the breadth of protection that these tests offer a monopolist, compared to an approach that considers both competitive harms and benefits. As one commentator has observed,

> Together, the sacrifice and no economic sense tests for unlawful exclusionary behavior offer the narrowest ground for condemning conduct as monopolistic. Taken literally, they avoid balancing because any reasonable prospect of net gain to the monopolist that does not come from injury to competition exonerates the defendant.[102]

In part, the controversy also stems from concern that profit-sacrifice may by its nature be a poor lens for examining some forms of potential exclusionary conduct, as discussed below.[103]

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

101 *See, e.g.*, Jan. 31 Hr'g Tr. at 30 (Edlin) (arguing that while profit sacrifice is an appropriate factor to consider as part of the analysis, it should not be used as a necessary test); Salop, *supra* note 9, at 320 (observing that "[a]s a literal matter, the profit-sacrifice standard is a test of anticompetitive purpose and intent," which is how the Court used it in *Aspen and Trinko*); *id*. at 374 ("profit sacrifice may be a useful piece of evidence in conjunction with other evidence, but when it is the sole liability standard, or a required prong of the liability standard, the profit-sacrifice test is likely to cause significant judicial errors without adding any benefits").

102 Hovenkamp, *supra* note 89, at 11; *see also* July 18 Hr'g Tr. at 25–26 (Pitofsky) ("[L]awyers can always come up with a plausible economic reason. That's not the issue. The issue is whether that reason is good enough to outweigh the anticompetitive effects."); Sherman Act Section 2 Joint Hearing: Exclusive Dealing Hr'g Tr. 104, Nov. 15, 2006 [hereinafter Nov. 15 Hr'g Tr.] (Marvel) ("I do not like the test . . . . [T]here is always economic sense in these practices, and . . . there will always be some plausible argument that could be made."); May 1 Hr'g Tr. at 77 (Baker) (arguing that the profit-sacrifice and no-economic-sense tests "put a thumb on the scales in favor of defendants").

103 *Compare, e.g.*, Melamed, *supra* note 80, at 1267 (arguing that "[t]he sacrifice test can provide a sound unifying antitrust principle for analyzing all exclusionary conduct that has efficiency benefits") with Elhauge, *supra* note 6, at 280 (countering that "there are

many undesirable forms of *unilateral* exclusionary conduct that do not involve short-term sacrifices of profit") *and* Salop, *supra* note 9, at 313 (noting that while the profit-sacrifice test "can be useful" in cases involving unilateral refusals to deal, it "is not generally a reliable indicator").

104 Melamed, *supra* note 80, at 1257.

105 *Id.* at 1258; *see also* Werden, *supra* note 6, at 433 (stating that "[t]he no economic sense test is predicated on the proposition that some potentially harmful conduct must be

applying these test in some circumstances, observing that they "can be difficult in cases involving simultaneous benefits for the defendant and cost increases for rivals"[107] or in settings lacking a "single, well-defined 'but for' scenario" for making the comparison needed to assess the challenged conduct's economic sense.[108]

Other commentators offer a variety of criticisms. Some criticize these tests for failing to focus on effects on consumers and competition. In the words of one panelist, "The fundamental problem . . . with all of these sacrifice tests is that these tests don't flow from any kind of first principles [based on] . . . consumer welfare."[109] Others make similar points.[110]

Critics also warn that a profit-sacrifice test can be overinclusive in that it might condemn 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 profit in expectation of future profits that result, at least in part, from taking business from competitors. The profit-sacrifice test is criticized on the ground that it may condemn such clearly

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107 Melamed, *supra* note 80, at 1261; *see also* Werden, *supra* note 6, 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.").

108 *See* Werden, *supra* note 6, at 420.

109 Jan. 31 Hr'g Tr. at 35 (Edlin).

110 *See* May 1 Hr'g Tr. at 77 (Baker) (arguing that the profit-sacrifice and no-economic-sense tests cause you to "take your eye off the ball" by focusing on "the defendant's virtue" rather than "harm to competition"); *id.* at 67 (Kolasky) ("[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") July 18 Hr'g Tr. 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 21, 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."); Salop, *supra* note 9, at 345 (describing the "hypothetical profits" of the profit-sacrifice test as "a highly imperfect (and generally biased) predictor of the impact of the conduct on competition and consumer welfare"); Jacobson & Sher, *supra* note 86, at 786 ("[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.").

procompetitive conduct.[111]

In addition, although these tests are based in part on purported ease of administration, critics have asserted that they are difficult to implement.[112] In particular, some critics stress, assessing what portion of an act's anticipated profits are exclusionary as opposed to non-exclusionary is apt to be difficult.[113] Others argue that predation screens such as profit sacrifice are not appropriate for exclusion cases, and warn about extending the predatory pricing paradigm to other forms of exclusionary conduct.[114] For instance, some critics maintain that the profit-

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111 *See, e.g.*, Jan. 31 Hr'g Tr. at 113–14 (Gilbert) ("[A] profit sacrifice test . . . doesn't . . . make any sense to innovation . . . [since] 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 6, at 274 (arguing that the profit-sacrifice test fails because sacrificing short-term profits to make investments that enable one to destroy rivals is ordinarily not a sign of evil but the mark of capitalist virtue); *see also* Dennis W. Carlton, *Does Antitrust Need to Be Modernized?*, J. ECON. PERSP., Summer 2007, at 155, 170 ("[P]ublic policy should encourage firms that want to invest in activities that consumers value in order to gain future sales from other 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.").

112 *See* May 1 Hr'g Tr. at 69 (Jacobson) ("it is a very, very difficult test to administer"); *id.* at 77 (Baker) (noting "tremendous problems with administrability"); *id.* at 75 (Elhauge) (contending that the no-economic-sense test is more difficult to administer than the rule of reason).

113 *See, e.g.*, Elhauge, *supra* note 6, 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."); Salop, *supra* note 9, 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 reducing competition as opposed to other causes).

114 *See, e.g.*, June 22 Hr'g Tr. at 122 (Brennan); May 1 Hr'g Tr. at 16 (Krattenmaker) ("Predatory pricing is not the only paradigm."); Susan A. Creighton *et. al.*, *Cheap Exclusion*, 72 ANTITRUST L.J. 975, 980 (2005) ("Although thorough scholarly investigation of exclusion came early in the context of predatory pricing, that does not mean that predatory pricing should be the paradigm for all exclusion cases. In fact, care

sacrifice/no-economic-sense tests are inappropriate for exclusive dealing because the only way exclusive-dealing arrangements make economic sense is "precisely because they lessen competition by rivals for the affected business."[115] Others have observed that these tests cannot usefully be applied to various forms of misleading and deceptive conduct, including sham litigation.[116]

Finally, some have questioned the basic premise that sacrifice tests are needed to address costs associated with false positives. As one panelist observed, "[T]here have been mistakes that have been made, but the idea that there's just constant false positives in Section 2 enforcement, I don't know where that's coming from."[117] Another panelist observed that, in his view, "modern example[s]" of false positives are "scarce," and, in any event, "[e]recting arbitrary hurdles because the right test is difficult to administer is . . . wrong-headed."[118] According to another commentator, the case for tests such as the no-economic-sense test "presume[s] a substantial threat of false positives and hence over-deterrence from the current state of the law, even though there is little or no evidence to support that fear in recent judicial treatments of dominant firm conduct."[119] And another panelist has recently argued that "the risk of false positives is now

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is warranted in applying more generally tests for predation derived from predatory pricing.").

115 Nov. 15 Hr'g Tr. at 59 (Jacobson) (stating that "as applied to exclusive dealing, the no economic sense test really does make no economic sense"); *see also* Jacobson & Sher, *supra* note 86, at 781 (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.").

116 *See* Creighton *et. al.*, *supra* note 114, at 985–86 n.39 ("[P]rofitability, economic rationality, or cost may not be very useful metrics for cheap exclusion, either because costs are low, zero, or indeterminate, or because the 'profits' involved may not result from efficient conduct."); Popofsky, *supra* note 7, at 463 ("The profit sacrifice test, if applied universally, would dismantle the protective sham litigation doctrine to the possible detriment of consumers.").

117 July 18 Hr'g Tr. at 23 (Pitofsky).

118 Jan. 31 Hr'g Tr. at 36 (Edlin); *see also* May 1 Hr'g Tr. at 86 (Jacobson) (stating that the concept that false positives are a problem is "larger in the eyes of the enforcement community" than in "the real world"); *id.* at 89 (Krattenmaker) and *id.* (Jacobson) (agreeing that false positive risk is more "ephemeral" than is commonly put forward).

119 Gavil, *supra* note 21, at 23.

efficiently as a defendant in a tying case qualify as an efficient competitor if it does not produce the other products involved in the tie? In the multiproduct 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 analysis of only that targeted product. Moreover, it is difficult to measure and compare efficiencies in multiproduct cases where there are joint costs. Similarly, the concept of an equally efficient competitor may be difficult to apply in the context of exclusive dealing, where a firm's efficiency may depend on how it distributes its products.

Thus, although the equally-efficient-competitor test has the virtue of focusing on the most clearly pernicious behavior, it may miss some practices that reduce competition and harm consumer welfare, particularly in settings where concerns with nascent competition are greatest. The test, like the proposed sacrifice tests, is a useful principle to consider when assessing certain types of conduct, such as rebates and discounts, but it cannot serve as a single standard for the broad range of conduct subject to challenge under section 2.

D. The Impairing-Rivals'-Efficiencies Test

This test, proposed by Professor Elhauge, reflects theories based on raising rivals' costs,[129] and asks "whether the alleged exclusionary conduct succeeds in furthering monopoly power (1) only if the monopolist has improved its own efficiency or (2) by impairing rival efficiency whether or not it enhances monopolist efficiency."[130] Thus, if the challenged conduct furthers monopoly power

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[129] *See* Hovenkamp, *supra* note 89, at 15–17 & n.53. *See generally* Steven C. Salop & David T. Scheffman, *Raising Rivals Costs*, 73 AM. ECON. REV. 267 (May 1983); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1987), for discussion of these theories.

[130] *See* Elhauge, *supra* note 6, at 315.

[131] *See* Hovenkamp, *supra* note 89, at 16 & n.54 (collecting cases and noting that "[m]any cases brought under both §§ 1 and 2 of the Sherman Act have acknowledged the theory").

[132] *See generally* Elhauge, *supra* note 6.

[133]

A hypothetical, ideal test would successfully balance several, potentially conflicting goals. The recent Antitrust Modernization Commission, for example, recommends that "[s]tandards for applying Section 2 of the Sherman Act's broad proscription against anticompetitive conduct should be clear and predictable in application, administrable, and designed to minimize overdeterrence and underdeterrence, both of which impair consumer welfare."[137] These are reasonable goals; the problem, however, is, that each test has relative advantages and disadvantages for serving different goals, and the goals themselves may conflict to a certain extent.

Moreover, the optimal balance among the various goals will differ for different forms of single-firm conduct. Thus, while some types of conduct, such as various types of discounting practices, offer clear consumer benefits, others, such as various forms of deceptive conduct, may offer none. Accordingly, while it may be appropriate to adopt a special test for the former taking into account the danger of inadvertently chilling procompetitive behavior, that consideration will not be at issue in the latter case. Indeed, even with respect to a single form of conduct, particular fact patterns may suggest the need for different weightings.

These tensions may best be resolved by continuing to work toward the development of conduct-specific tests, as the Supreme Court has done with respect to predatory pricing and buying—at least in areas, which, like pricing practices, are "the essence of competition" and where the potential chilling of procompetitive conduct may be of special concern. However, where appropriate conduct-specific tests cannot be developed, the *Microsoft* rule-of-reason approach provides the optimal framework. Although the rule of reason may afford somewhat less certainty to businesses under certain circumstances, neither current scholarship nor the FTC/DOJ hearings have established a reliable basis for weighing the benefits of greater certainty against its costs. Similarly, while rules such as the sacrifice tests may reduce the danger of false positives, there is as of yet no clear basis for assessing the significance of that danger or for comparing it to the potential harm from false negatives. In these circumstances, replacing a neutral rule of reason with "thumb on the scales" sacrifice tests, or importing, across the board, an express requirement of disproportionality as a necessary element of section 2 liability, would not appear justified.

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[137] ANTITRUST MODERNIZATION COMM'N, *supra* note 2, at 88.