St. John's University School of Law

Exclusionary Conduct in Antitrust

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St. John's University School of Law

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PROFESSIONAL CORPORATION

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The Sherman Act

- Section 1 prohibits *every* contract, combination, and conspiracy “in restraint of trade.”
- Section 2 outlaws “[*e*]*very* person who shall monopolize, or attempt to monopolize.”
- Seriously?

The Sherman Act

- "One problem presented by the language . . . is that it cannot mean what it says. The statute says that 'every' contract that restrains trade is unlawful. But, as Mr. Justice Brandeis perceptively noted, restraint is the very essence of every contract; read literally, § 1 would outlaw the entire body of private contract law."
  - Justice Stevens in *National Society of Professional Engineers v. United States*, 435 U.S. 629, 682-88 (1978).

The Sherman Act

- So how did antitrust law overcome this impossible beginning and become the critically important set of laws that Lewis Bernstein enforced throughout his great career?
- As Justice Frankfurter put it, “[t]he vagueness of the Sherman Law was saved by imparting to it the gloss of history.”
  - FTC v. Motion Picture Adv. Serv. Co., 344 U.S. 392, 405 (1953) (dissent).
- The Sherman Act became the common law of competition.

The Sherman Act

- As the Court said more recently, “the Sherman Act’s use of ‘restraint of trade’ ‘invokes the common law itself . . . not merely the static content that the common law had assigned to the term in 1890.”
  - *Leegin v. PSKS*, 551 U.S. 877 (2007).
- This has led to dramatic changes unsurpassed in most other areas of the law.

The Sherman Act

- In 1977, when Lew Bernstein retired from the Antitrust Division, an agreement between a parent and subsidiary could be challenged as an unlawful conspiracy; resale price fixing was illegal; so was granting an exclusive territory to a dealer; so were many forms of selective price cutting.
- Starting that very year, 1977, however, the antitrust world began to change.
- Today, none of these activities is necessarily illegal, and almost all are routinely sustained.

Exclusionary Conduct

- My focus today will be on one important aspect of these dramatic changes: the law of monopolizing or attempting to monopolize.
- The issues are of great importance to our economy.
  - Was it right to break up AT&T in 1982?
  - Was Microsoft acting unlawfully when it squeezed out the Netscape browser?
  - Is it illegal for Google to improve its search results if some websites' rankings drop as a result?
  - Is price cutting illegal if rivals go out of business as a result?

Exclusionary Conduct

- Sherman Act § 2 makes it illegal to "monopolize" or "attempt to monopolize."
- The status of monopoly has never, itself, been illegal.
- The question has always been what conduct qualifies as monopolizing within the meaning of the statute.

Alcoa

- Almost all Sherman Act enforcement in the first several decades was directed at concerted activity involving two or more actors.
- The first significant single-firm conduct case was brought by the DOJ Antitrust Division, then led by the legendary Thurmond Arnold, in 1938, against the Aluminum Company of America – Alcoa.
- Following a two-year (yes, really) trial, the district judge ruled for Alcoa. On direct appeal to the Supreme Court, the Court could not muster a quorum. Congress then passed a statute appointing the Second Circuit as the court of last resort in the case.

Alcoa

- The panel hearing the case was the famous trio of Learned Hand, Augustus N. Hand, and Thomas Swan.
- The judgment was reversed.
- Relying primarily on the fact that Alcoa constantly expanded its production capacity, the court ruled that Alcoa had unlawfully “monopolized” the aluminum industry.

Alcoa

- The legal standard?
  - "The successful competitor, having been urged to compete, must not be turned upon when he wins." If monopoly is "thrust upon" the defendant, or if its market position is achieved solely "by virtue of [its] superior skill, foresight and industry," that is not unlawful.
  - But: "In order to fall within § 2, the monopolist must have both the power to monopolize, and the intent to monopolize. To read the passage as demanding any 'specific' intent makes nonsense of it, for no monopolist monopolizes unconscious of what he is doing."
  - Simply expanding production capacity qualified as unlawful.

Alcoa

- The court said:
  - "[Alcoa] insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel. Only in case we interpret 'exclusion' as limited to manoeuvres not honestly industrial, but actuated solely by a desire to prevent competition, can such a course, indefatigably pursued, be deemed not 'exclusionary.' So to limit it would in our judgment emasculate the Act . . . ."

1945 - 1975

- Alcoa stood as the governing precedent for the next three decades – Lewis Bernstein's whole career. Its standard was largely adopted by the Supreme Court in American Tobacco (1946) and Grinnell (1966), so that any "willful acquisition or maintenance of monopoly power" was unlawful.
- In the same period, the Supreme Court decided cases such as Utah Pie, in which price cutting leading to a "declining price structure" was found to violate a related antitrust law, the Robinson-Patman Act.
- For firms with large markets shares, divining how they might compete safely was a real challenge.

Enter the academics

- By the mid-1970s, academics all over were routinely savaging the Supreme Court's antitrust jurisprudence.
  - The most prominent critics were Robert Bork and others associated with the "Chicago School."
  - But others, less committed to Chicago School laissez-faire, such as the "Harvard School," also chimed in.
  - The consistent refrain of all these critics was for an economic approach focused on consumers. Antitrust should encourage competition as a process designed to aid consumers through lower prices, greater output, better quality, and increased innovation.

Sylvania, Berkey, and the IBM cases

- The economic approach took some to wind its way through the courts. The Supreme Court's 1977 decisions in Sylvania and Brunswick endorsed the economic approach generally, but the Court decided no monopolization case until 1992.
- The courts of appeals, however, dived right in.
- Decisions by the Tenth and Ninth Circuits from 1975 to 1982 departed markedly from Alcoa in absolving IBM of monopolization claims.
- And in 1979, the Second Circuit effectively overruled its Alcoa precedent in the Berkey Photo case.

Defining Exclusionary Conduct

- Departing from Alcoa was only a beginning. There was (and is) no consensus of what conduct was lawful and what was exclusionary and unlawful.
- Some Chicago School devotees, like now-judge Frank Easterbrook, advocated for making all single-firm conduct lawful on the ground that truly harmful conduct was so rare as to not warrant notice. They posited that conduct that harms or even excludes rivals, like price cutting, is often beneficial to consumers.
- But what are now called post-Chicago theorists advocated for greater intervention.

Defining Exclusionary Conduct

- One of the key post-Chicago points was "raising rivals' costs" or RRC.
- Under the RRC approach, if a dominant firm enters arrangements with customers or suppliers that deny (or render more costly) rivals' access to needed customers or inputs, the increased costs of the rivals will allow the dominant firm to raise its own prices – so that consumers, not just rivals, are harmed.
  - Devoted Chicagoans point out that RRC was in fact acknowledged by the Chicago School – although it was a minor footnote at best.

Defining Exclusionary Conduct

- But RRC can raise as many questions as it answers. Foreclosure of customers or inputs may raise rivals costs, but what if the mechanism of gaining the customers or inputs is itself competitive.
  - For example, if customers bid out their business for the best offer and the dominant firm wins, the customers may be "foreclosed," but the foreclosure is attributable to the competitive process.
  - Forbidding the dominant firm from aggressive competition to gain the business may be more harmful than letting it win.

Defining Exclusionary Conduct

- The total laissez-faire approach to single-firm conduct advocated by Judge Easterbrook and some others has not prevailed, although echoes of it sometimes appear in the opinions of judges like Antonin Scalia and Clarence Thomas.
- Most courts and analysts today acknowledge RRC as a viable theory of consumer harm and, although the Alcoa standard is long gone, antitrust will intervene to prevent conduct that harms consumers absent countervailing pro-consumer justifications.

Defining Exclusionary Conduct

- A variety of different tests have been proposed in an effort to have a single test for all single-firm conduct:
  - No economic sense;
  - Profit sacrifice;
  - Competitive effects balancing;
  - Disproportionality.
- But all have flaws depending on the context.
- Most agree that there is no good one-size-fits-all test.
- For many of the common types of potentially exclusionary conduct, there is no consensus approach.

Predatory Pricing

- One area of lesser controversy today is "predatory pricing," that is, cutting prices in a manner that may drive rivals out of business.
- Following an influential article by Harvard professors Areeda and Turner, and Supreme Court rulings in Matsushita (1986), Brooke Group (1993), and linkLine (2009), it is now clear that pricing is predatory only if
  - Below some (as yet undefined) measure of the defendant's incremental costs;
  - With a reasonable expectation that the defendant will "recoup" the profits lost once the rival competition has been removed.

Exclusive dealing

- Long-term exclusive agreements covering a large fraction of the customer base may raise rivals' costs, prevent entrants from achieving efficient scale, and other wise harm consumers.
- But what fraction constitutes the "substantial foreclosure" of the affected market that all courts agree is necessary?
- And what if the exclusives are the product of competition for the contract, as when the business is put out for bid?

Tying or bundling

- Agreements under which a firm that is dominant in product A tells customers that they must also take product B in order to get A are called “tying”;
- Arrangements under which customers get a discount on A if they buy B are called bundling.
- Both involve the use of the firm’s power over A to induce customers to buy B, which can foreclose rivals just selling B.
- How do we distinguish between anticompetitive compulsion and aggressive discounting or salesmanship?

Loyalty discounts

- When a dominant firm tells customers that they can get, say, a 25% discount if they buy 80% of their requirements from the defendant, that is called a loyalty discount.
- The practical effect is the same as exclusive dealing, but the conduct involves discounting.
- So do we apply a predatory pricing test so that the agreements are lawful unless the prices are below cost, or do we look at the percentage of the market foreclosed and apply an exclusive dealing analysis?

Product design

- Keurig coffee machines make coffee from Keurig's own, as well as rivals', K-Cups.
- Keurig develops machine version 2.0, which accepts only Keurig's own cups with a proprietary RFID tag.
- How do we analyze this?

Going forward

- There are no satisfactory answers to these questions, which continue to confound the courts, and it will take the law some time to develop answers.
- The paper my colleague, Elyse Dorsey, and I have written for St. John's attempts to address one important part of these issues.
- Our point is that the law should look, not only at what the defendant has done, but also the countermeasures the complainant has taken – or not taken.

Going forward

- Our basic point is that if the plaintiff is losing because it
  - Has not really tried very hard to gain the business itself, as when it could have met the defendant's discounts or other benefits but chose to maintain its profit margins;
  - Is less efficient, as with a higher cost structure that prevents it from competing effectively; or
  - Has simply lost out in competition for the contract in issue
- That plaintiff does not have much of a claim.

Going forward

- We recognize that this analysis is not a perfect answer.
  - Even a less efficient rival may cause the defendant to have to lower prices to consumers.
- But separating the cases where the plaintiff just can't cut it from those where the exclusion is truly harmful to consumers is difficult; and, in the process, legitimate competition from the defendant may be discouraged – a result that harms all consumers in the long run.
- So until a better screen is developed, we suggest that this kind of equally-efficient rival screen provides a useful starting point for separating the worthy cases from the bad ones.

Thank you!

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