Chapter Two

Monopoly, Exclusion and Intrabrand Competition

Perhaps no areas of antitrust law reflect the different assumptions and philosophies of the Chicago and post-Chicago antitrust schools more than monopolization and vertical restraints. Whereas the Chicago school sees little risk from exclusionary conduct, even by monopolists, and even less risk from vertical intrabrand distribution restraints,[1] post-Chicago and other scholars recognize that raising rivals' costs can frequently be a profitable strategy for dominant firms[2] and that intrabrand vertical restraints such as resale price maintenance (RPM) may well harm consumers.[3] The current administration's policy towards monopolization reflects a schism between the Justice Department's (DOJ) laissez-faire, Chicago school approach and the Federal Trade Commission's (FTC) more balanced, traditional analysis. On intrabrand vertical restraints, however, both agencies have departed the field and made it increasingly difficult for private enforcers to succeed.

The next administration must chart a new course consistent with antitrust's traditional concerns about monopoly power and modern economic thinking about exclusionary conduct. This chapter provides a roadmap for such a new course starting with a critique of the movement to roll back monopolization law in the name of fostering innovation and not chilling procompetitive conduct. The chapter makes recommendations for reinvigorating Section 2, including recommendations for tests for exclusionary conduct – in general and with respect to specific types of conduct – that balance concerns for "false negatives" as well as "false positives." It supports proposals for more effective remedies in monopolization cases, such as the use of monetary sanctions. And, it urges the next administration and the courts to embrace *Kodak*'s post-Chicago insights into how markets characterized by significant information imperfections, post-purchase switching costs, and related factors may be particularly susceptible to opportunistic conduct with exclusionary and other anticompetitive effects. These insights can contribute importantly

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[1] *See, e.g.,* ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 432 (1993) ("size will not last if it does not rest on superior efficiency"; predation is "rare"); *id.* at 297 ("[A]ll vertical restraints are beneficial to consumers and should for that reason be completely lawful.").

[2] *See, e.g.,* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1986).

[3] *See, e.g.,* 8 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, ¶ 1604, at 35 – 68 (2d ed. 2004).

to the sound evolution of Section 2 law generally and to vertical restraint analysis in particular. This is so for a potentially broad array of market spaces beyond the "aftermarket" context in which *Kodak* case law has developed to date. On intrabrand vertical restraints, it urges the administration to recognize the importance of intrabrand competition in an economy characterized by increasing concentration of retail markets and to support efforts to restore the per se rule barring RPM and/or to strengthen the newly minted rule of reason. Specifically, the chapter's major recommendations are as follows:

MAJOR RECOMMENDATIONS

With respect to monopolization and exclusion, the next administration should:

- Take a more aggressive enforcement posture towards exclusionary conduct by dominant firms and renew antitrust's historic skepticism of durable monopolies.

- Take seriously *Kodak*'s post-Chicago recognition that information deficiencies and other "consumer protection" market imperfections may give a firm market power, regardless of conventional market share analysis, and may make markets susceptible to opportunistic conduct with exclusionary and other anticompetitive effects.

- Be more open to the views and experience of foreign enforcement agencies with respect to the prosecution of abusive conduct by dominant firms.

- Abandon efforts to promote a single test for exclusionary conduct under Section 2, such as the profit sacrifice or "no economic sense" test.

- Support *Aspen Skiing* and *Kodak's* holdings that a monopolist's refusal to deal that results in significant exclusionary effects may be actionable when the monopolist fails to establish a legitimate procompetitive justification, at least where the monopolist has previously dealt with the competitor or discriminates between the competitor and other customers.

- Revitalize the essential facilities doctrine as an independent theory of liability for purposes of injunctive relief to ensure competitor access to infrastructure or networks when such access is essential for competition in adjacent markets that produce important public benefits.

- Treat a vertically integrated monopolist's refusal to sell or license its intellectual property to a downstream competitor the same as a refusal to sell or provide access to physical property.

- Reject cost-based safe harbors for loyalty and bundled discounts by dominant firms and support a structured rule of reason that would allow plaintiffs to establish that such discounts are prima facie exclusionary under certain conditions.

- Look for opportunities to bring predatory pricing cases and encourage courts to develop a structured rule of reason that is more consistent with modern economic thinking about predatory pricing strategies than is current law.

- Seek to employ structural remedies in appropriate cases, give more serious consideration to equitable monetary remedies, and support legislation to allow both agencies to obtain civil penalties in Section 2 cases.

- Sharpen the analysis of exclusive dealing arrangements.

- Retain the current modified per se rule for tying, as articulated in *Jefferson Parish*, with certain caveats.

With respect to intrabrand vertical restraints, the next administration should:

- Give more recognition to the importance of intrabrand competition to the economy, particularly with respect to multibrand retailers, and be attentive to the insights of the dual-stage model of product distribution.

- Support legislation to overturn the Supreme Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.* and restore the per se rule for minimum RPM.

- Alternatively, develop a structured rule of reason for courts to use in applying *Leegin* that would treat RPM as "inherently suspect" in most circumstances under the framework suggested by *Polygram Holding* and consider adopting guidelines setting forth a structured rule of reason for nonprice intrabrand restraints as well.

- Support repeal or reform of the *Colgate* doctrine legislatively or judicially insofar as that doctrine treats RPM coerced by a manufacturer's threatened refusal to deal as unilateral conduct.

- Renew efforts to bring challenges to vertical nonprice distribution restraints where powerful incumbent distributors seek to restrict distribution to innovative retailers, as in *Toys "R" Us*.

I. Monopolization

A. General Considerations

The next administration should take a more aggressive enforcement posture towards exclusionary conduct by dominant firms and renew antitrust's historic skepticism of durable monopolies.

Federal enforcement of Section 2 of the Sherman Act has declined dramatically under the Bush II administration. The Antitrust Division in the current administration has not brought a single monopolization case.[4] In contrast, during the Clinton administration,

[4] The current workload statistics compiled by DOJ indicate that one Section 2 case was brought in 2002. *See* U.S. DEP'T OF JUSTICE, ANTITRUST DIV., WORKLOAD STATISTICS FY 1998 – 2007, at 5, *available at* http://www.usdoj.gov/atr/public/workstats.htm. However, that appears to be an error, the result of miscoding a Section 1 case as a Section 2 case. The same statistics erroneously show only one Section 1 civil case for 2002, whereas two were actually filed. *See* Complaint, United States v. Nat'l Ass'n of Police Equip. Distribs. Inc., C.A. No. 02-80703 (S.D. Fla. July 25, 2002), *available at* http://www.usdoj.gov/atr/cases/f11600/11655.htm; Complaint, United States v. The Mathworks, Inc., C.A. No. 02-888-A (E.D. Va. June 21, 2002), *available at* http://www.usdoj.gov/atr/cases/f11300/11369.htm. Earlier compilations of the workload statistics for 2002 show no Section 2 cases and two Section 1 civil cases. *See, e.g.,* U.S. DEP'T OF JUSTICE, ANTITRUST DIV., WORKLOAD STATISTICS FY 1993 – 2002.

the Antitrust Division brought at least seven monopolization cases,[5] including notable cases against Microsoft, American Airlines, and Dentsply.[6] The number of Section 2 investigations also dropped appreciably,[7] and the Antitrust Division accepted a settlement in the *Microsoft* case that has been largely ineffectual.[8]

While stepping down its own enforcement activity, DOJ stepped up its advocacy of a narrower role for Section 2. In nearly all of its Supreme Court amicus briefs in private Section 2 actions – *Trinko*,[9] *Weyerhaeuser*,[10] and now *linkLine*[11] – DOJ has sided with the monopolist or would-be monopolist and advocated a permissive (i.e., noninterventionist) standard of exclusionary conduct.[12] And in his opening remarks for the agencies' joint

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[5] *See* William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 ANTITRUST L.J. 377, 449 (2003). The Justice Department workload statistics for fiscal years 1993 – 2002 indicate a somewhat higher number.

[6] *See* United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001) (upholding complaint for monopolization of operating systems software market); United States v. AMR Corp., 335 F.3d 1109 (10th Cir. 2003) (upholding dismissal of complaint alleging monopolization of certain airline passenger markets); United States v. Dentsply Int'l, Inc., 399 F.3d 181 (3rd Cir. 2005) (reversing dismissal of complaint for monopolization of artificial teeth market). To be sure, the Bush II Antitrust Division deserves some credit for appealing adverse lower court decisions in *American Airlines* and *Dentsply*.

[7] From 1993 to 2000, DOJ initiated an average of 11.75 monopolization investigations per year. From 2001 to 2007, the average dropped to 8.29 per year. *See* U.S. DEP'T OF JUSTICE, ANTITRUST DIV., WORKLOAD STATISTICS FY 1993 – 2002 (for years 1993 – 97) and U.S. DEP'T OF JUSTICE, ANTITRUST DIV., WORKLOAD STATISTICS FY 1998 – 2007 (for years 1998 – 2007).

[8] *See infra* note 86.

[9] *See* Brief for the United States & the Fed. Trade Comm'n as Amici Curiae Supporting the Petitioner at 8, Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004) (No. 02-682) (urging Court to reverse the Second Circuit's ruling refusing to dismiss class action complaint under Section 2 because complaint did not meet "demanding test" for establishing liability for a unilateral refusal to deal).

[10] *See* Brief for the United States as Amicus Curiae Supporting Petitioner, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069 (2007) (No. 05-381) (arguing that the Ninth Circuit had erred by not requiring that the plaintiff in a predatory bidding case apply a variation of the predatory pricing standard of *Brooke Group*).

[11] *See* Brief for the United States as Amicus Curiae, Pacific Bell Tel. Co. v. linkLine Commc'ns, Inc., No. 07-512, *cert. granted*, 2008 U.S. LEXIS 5235 (June 23, 2008) (urging Supreme Court to grant certiorari to reverse Ninth Circuit's interlocutory ruling declining to dismiss a price-squeeze complaint).

[12] The one exception was DOJ's brief opposing certiorari in *LePage's*. *See* Brief for the United States as Amicus Curiae, 3M Co. v. LePage's Inc., 542 U.S. 953 (2004) (No. 02-1865), *denying cert.* to 324 F.3d 141 (3d Cir. 2003) (criticizing court of appeals' failure to identify the specific factors that made 3M's bundled discounts anticompetitive, but recommending against certiorari because the case was not a good vehicle for the Court to provide guidance). At the lower court level, DOJ also filed one brief against a monopolist in a case involving the standing of purchasers to obtain damages on a *Walker Process* claim. *See* Brief for the

hearings on Section 2, the head of the Antitrust Division emphasized the need to construe Section 2 "to avoid chilling procompetitive conduct" and that "the benefit of the doubt should go to defendants, not to plaintiffs . . . ."[13] DOJ has also taken the EU to task for its less permissive approach towards abusive conduct by monopolists, especially in connection with the EU Microsoft case, which provoked a heated response from the EU Competition Commissioner.[14]

The FTC has been more active in recent years, filing important Section 2 cases involving deception of standard setting organizations by patent holders[15] and abuse of FDA procedures by brand name drug makers to delay entry by generics.[16] Moreover, while the

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United States & Fed. Trade Comm'n as Amici Curiae Supporting Plaintiffs-Appellants, *In re* DDVAP Direct Purchaser Antitrust Litigation, No. 06-5525-cv (2d Cir. 2007).

[13] Thomas O. Barnett, Ass't Att'y Gen., Antitrust Div., The Gales of Creative Destruction: The Need for Clear and Objective Standards for Enforcing Section 2 of the Sherman Act, Remarks at the Antitrust Div. and Fed. Trade Comm'n Hearings Regarding Section 2 of the Sherman Act 17 (June 20, 2006) (quoting Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusal to Deal – Why* Aspen *and* Kodak *Are Misguided*, 68 ANTITRUST L.J. 659, 675 (2000)), *available at* http://www.justice.gov/atr/public/speeches/216738.pdf. Barnett noted, "It is important to remember that every time a firm is kept from engaging in aggressive conduct because it fears an unnecessarily expansive interpretation of the antitrust laws, competition is harmed." *Id.*

[14] *See* David Lawsky, *EU Official Lambasts U.S. Justice Dept on Microsoft*, REUTERS, Sept. 19, 2007, *available at* http://www.reuters.com/article/politicsNews/idUSL1926927820070919. Commentators called DOJ's criticism of foreign enforcers' actions on Microsoft "defensive, patronizing, and tactless," and suggested that "[t]hese undiplomatic public criticisms risked inflaming relationships between U.S. and foreign competition authorities and potentially undermined the credibility of U.S. enforcement officials." Harry First & Andrew I. Gavil, *Re-framing Windows: The Durable Meaning of the* Microsoft *Antitrust Litigation*, 2006 UTAH L. REV. 641, 711, 712 (2006). Rather than publicly attack the European Commission's approach to dominant firm conduct, the next administration could benefit from the experience of foreign enforcement agencies. *See* J. Thomas Rosch, Comm'r, Fed. Trade Comm'n, I Say Monopoly, You Say Dominance: The Continuing Divide on the Treatment of Dominant Firms, Is it the Economics?, Speech at the Int'l Bar Ass'n Antitrust Section Conf. 19 (Sept. 8, 2007), *available at* http://www.ftc.gov/speeches/rosch/070908isaymonopolyiba.pdf (suggesting that "it may be time for a thoughtful and dispassionate study of the consequences of our respective competition law enforcement efforts respecting the conduct of dominant firms").

[15] *See* Complaint, *In re* Union Oil Co. of Cal., FTC Dkt. No. 9305 (Mar. 4, 2003), http://www.ftc.gov/os/adjpro/d9305/030304unocaladmincmplt.pdf (alleging that Unocal illegally acquired monopoly power in the technology market for producing low-emission gasoline mandated by the California Air Resources Board (CARB) by misrepresenting that its technology was nonproprietary); *In re* Rambus, Inc., FTC Dkt. No. 9302 (Aug. 2, 2006), http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf (finding that Rambus monopolized the markets for four computer-memory technologies incorporated into industry standards for D-RAM chips by misrepresentations to standard setting organization), *rev'd*, 522 F.3d 456 (D.C. Cir. 2008).

[16] *See* Complaint, *In re* Biovail Corp., FTC Dkt. No. C-4060 (Apr. 23, 2002), http://www.ftc.gov/os/2002/04/biovailcomplaint.htm; Complaint, *In re* Bristol-Myers Squibb Co., FTC

FTC joined DOJ's amicus briefs in *Trinko* and *Weyerhaeuser*, it pointedly did not join DOJ's brief in *linkLine*, noting that "[t]here is no apparent justification . . . for turning back 60 years of case law that embraces price-squeeze claims under Section 2 of the Sherman Act."[17]

DOJ's virtual interment of Section 2 comports with the Supreme Court's dicta in *Trinko*, in which the Court emphasized the "especially costly" harms from "false condemnations," "[m]istaken inferences," and "false positives," which "chill the very conduct the antitrust laws are designed to protect," and therefore "counsels against an undue expansion of § 2 liability."[18] Moreover, Justice Scalia's opinion for the Court celebrated the *virtues* of monopoly, maintaining:

> The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices – at least for a short period – is what attracts "business acumen" in the first place; it induces risk taking that produces innovation and economic growth. 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*.[19]

Dkt. No. C-4076 (Mar. 7, 2003), http://www.ftc.gov/os/2003/03/bristolmyerscmp.pdf. The FTC also recently brought a case under a monopolization theory that involved "reverse payments" by a brand name drug maker to delay entry by generics. *See* Complaint, FTC v. Cephalon, Inc., No. 08-0244 (D.D.C. Feb. 13, 2008), http://www.ftc.gov/os/caselist/0610182/080213complaint.pdf. According to Commissioner Kovacic, *Biovail*, *Bristol-Myers Squibb*, and *Unocal* "yielded some of the largest benefits to consumers in the history of FTC [monopolization] cases" and "the FTC's program of monopolization and attempted monopolization cases since 2001 arguably has no parallel in the agency's history." William E. Kovacic, *The Importance of History to the Design of Competition Policy Strategy: The Federal Trade Commission and Intellectual Property*, 30 SEATTLE U. L. REV. 319, 326 (2007). The Pitofsky-led FTC brought four monopolization cases, including *Mylan*, *Intel*, and *Dell*. *See* Kovacic, *supra* note 5, at 449.

[17] *See* Fed. Trade Comm'n, Statement of the Federal Trade Commission: Petition for a Writ of Certiorari in Pacific Tel. Co. d/b/a AT&T California v. linkLine Commc'ns, Inc. 6 (May 23, 2008), *available at* http://www.ftc.gov/os/2008/05/P072104stmt.pdf.

[18] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 414 (2004).

[19] *Id.* at 407; *see* Barnett, *supra* note 13, at 6 ("The potential to obtain monopoly profits serves as an important incentive to create better products for consumers.").

The Supreme Court and DOJ have apparently adopted the Schumpeterian hypothesis, which views monopoly, rather than competition, as being most conducive of innovation. [20] This perspective naturally implies tolerant monopolization standards.[21]

This favorable view of monopoly is contrary to the long tradition of antitrust that approaches monopolies with skepticism. As Professor Gavil notes, "the evils of monopoly are widely recognized: restricted output, higher prices, perhaps diminished incentives to pursue cost-cutting measures and innovation, and increased incentives to pursue rent-seeking strategies, as with predation."[22] Judge Hand's observation about monopoly power in *Alcoa* is antitrust bedrock: "Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry a stimulant, to industrial progress; that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone."[23]

To be sure, monopolies built solely on "superior skill, foresight, or industry" have never been condemned, for as Judge Hand also noted, "the successful competitor, having been urged to compete, must not be turned upon when he wins."[24] But, as Professor Gavil

[20] Assistant Attorney General Barnett titled his opening remarks at the Section 2 hearings *The Gales of Creative Destruction,* and cited "Schumpeter's observation that high profits serve as 'baits that lure capital on to untried trails,' thereby producing a 'perennial gale of creative destruction' resulting in better ways to satisfy our needs and desires." Barnett, *supra* note 13, at 6. The Schumpeterian hypothesis is not merely that *potential* monopoly returns promote innovation but that large firms and monopolies are more innovative than businesses in competitive markets, primarily because they are better able to appropriate the returns from risky investments. *See generally* Richard M. Brunell, *Appropriability in Antitrust: How Much is Enough?,* 69 ANTITRUST L.J. 1, 1 – 3 (2001); Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation*, 74 ANTITRUST L.J. 575, 578 (2007).

[21] *See* ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 86 (2007) [hereinafter AMC REPORT] ("This view – that the prospect of gaining monopoly is an appropriate incentive for competition and innovation – implies that the application of overly stringent antitrust rules for monopolists' conduct could discourage competition and innovation.").

[22] *See* Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 ANTITRUST L.J. 3, 3, (2004).

[23] United States v. Aluminum Co. of Am., 148 F.2d 416, 427 (2d Cir. 1945).

[24] *Id.* at 430. Yet it should be recalled that Professors Areeda and Turner long favored a "no fault" monopolization offense (and dissolution) for significant and persistent monopolies, even those based on superior skill, believing that the disincentive effect of such a rule would be minimal. *See* 3 PHILLIP AREEDA & DONALD F. TURNER, ANTITRUST LAW ¶¶ 614 – 23 , at 35 – 71 (1978).

notes, "Antitrust law's past tolerance of monopoly . . . has at best been grudging."[25] Persistent monopolies have been viewed with suspicion because they are not the expected result of our competitive system. Also, monopoly power makes many exclusionary distribution strategies plausible, allowing monopolists to protect, prolong, and entrench their monopolies.[26]

A lax approach towards Section 2 enforcement is not justified by a general fear of chilling innovation. Modern economic theory and empirical evidence do not support the Schumpeterian hypothesis that monopoly is more conducive to innovation than competitive markets.[27] The quest for *monopoly* does not drive most innovation; what drives most innovation is the quest for competitive advantage and the "threat of being left behind," which is a function of vigorous competition.[28] Moreover, a permissive

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[25] Gavil, *supra* note 22, at 33; *see also* Lawrence A. Sullivan & Ann I. Jones, *Monopoly Conduct, Especially Leveraging Power from One Product or Market to Another*, *in* ANTITRUST, INNOVATION, AND COMPETITIVENESS 165, 167 (Thomas M. Jorde & David J. Teece eds., 1992) ("Evil though it may be, monopoly power and even exploitive pricing must be tolerated, so long as the power was innocently gained and is not used in ways yielding even further social harm.").

[26] *See* William S. Comanor, *Is There a Consensus on the Antitrust Treatment of Single-Firm Conduct?*, 2008 WIS. L. REV. 387, 390 (2008) ("[E]ven if market power by itself is not unlawful, it is often a critical element for the successful prosecution of exclusionary conduct.").

[27] *See* F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 637 (3d ed. 1990) (concluding that competition acts as a stimulus to R&D, up to a point); Baker, *supra* note 20, at 583 – 86 (discussing empirical studies, which generally contradict Schumpeterian hypothesis); *see also* F.M. Scherer, *Technological Innovation and Monopolization* 48 (Oct. 2007), *available at* http://ssrn.com/abstract=1019023 (review of cases indicates "dominant firms have accumulated far more monopoly power than is necessary to motivate and sustain the most rapid and beneficial rate of technological progress"). Indeed, in contrast to her counterpart at DOJ, Deborah Majoras, the former chairman of the FTC, in her opening remarks at the agencies' joint hearings on Section 2, emphasized recent studies finding that undistorted product market competition was the key explanation of differences in levels of productivity across countries, a decidedly un-Schumpeterian perspective. *See* Deborah Platt Majoras, Chairman, Federal Trade Commission, The Consumer Reigns: Using Section 2 to Ensure a "Competitive Kingdom", Speech at Fed. Trade Comm'n and Antitrust Div. Hearings on Section 2 of the Sherman Act 1 – 2 (June 20, 2006) (citing WILLIAM W. LEWIS, THE POWER OF PRODUCTIVITY: WEALTH, POVERTY, AND THE THREAT TO GLOBAL STABILITY (2004)), *available at* http://www.ftc.gov/speeches/majoras/060620revisedhearingonsection2.pdf.

[28] As Professor Gavil notes, "[U]nless firms are hopelessly disconnected from the real world, the pipe dream of 'monopoly' can hardly be the major incentive that drives most firms to innovate. *Profits*, not monopoly profits, are the principal spur to innovation that 'attracts business acumen.'" Gavil, *supra* note 22, at 43. It is ironic that at a time when a consensus is developing that overly strong patent rights diminish innovation, the Supreme Court and conservative antitrust advocates have trotted out simplistic pro-patent incentive arguments to limit antitrust enforcement against monopolies. *See* Brunell, *supra* note 20 (cataloging such "appropriability" arguments, as well as competition counterarguments).

approach towards exclusionary conduct is at least as likely to chill innovation as to promote it, as rivals or potential rivals to dominant firms are dissuaded from making risky investments by a fear of increased exclusionary conduct, which in turn reduces pressure on dominant firms to innovate.[29] Accordingly, based on his review of the evidence, Professor Scherer argues that "[t]he benefit of the doubt in high-technology monopolization matters ought to be resolved in favor of keeping structural and behavioral barriers to innovative new entry as low as possible."[30]

Nor is a lax approach justified by a fear of deterring specific procompetitive conduct of dominant firms. There is no evidence that dominant firms have refrained from procompetitive conduct because of a fear of liability or litigation under prevailing Section 2 standards.[31] And whatever risk of overdeterrence results from a more restrictive policy towards dominant firms, there is no good reason to believe that the costs of such a policy outweigh the costs of underdeterrence from a lax policy, including the actual exclusion of competitors from monopolized markets and the chilling effect of potential exclusionary conduct on new entry. In short, what is called for is a balanced approach that appreciates the costs of false positives *and false negatives.*[32]

The prevailing view is that concerted action among competitors is much more dangerous than unilateral conduct, and thus enforcement of Section 1 is more important than enforcement of Section 2.[33] Indeed, the unilateral conduct rubric itself connotes a

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[29] *See* Stephen C. Salop & R. Craig Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft,* 7 GEO. MASON L. REV. 617, 662 (1999); *see also* Gavil, *supra* note 22, at 40 ("What firm will undertake—and what investor will seriously support—entry into a market occupied by a dominant firm that has already demonstrated its penchant for entry-deterring strategies—especially if it has already received the imprimatur of the courts?").

[30] Scherer, *supra* note 27, at 48.

[31] *See* Gavil, *supra* note 22, at 51 (noting that there "is no data to support the accusation that Section 2 is over-deterring some kind of 'legitimate' conduct").

[32] Professor Gavil suggests that the costs of false negatives has been understated "because it can be so difficult for courts to restore competition once it has been lost . . . ." *Id.* at 39. At the same time, the cost of false positives has been overstated because if dominant firms are truly more efficient than their rivals, they have many unquestionably lawful tools with which to compete; "the 'self-correcting' market will favor them, and their rivals will fade of their own accord." *Id.* at 41.

[33] *See* Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 408 (2004) (referring to collusion as "the supreme evil of antitrust"); *see also* R. Hewitt Pate, Ass't Att'y Gen., Antitrust Div., International Anti-Cartel Enforcement, Speech at the 2004 ICN Cartels Workshop (Nov. 21, 2004), *available*

somewhat benign phenomenon. Yet, the conduct at issue under Section 2 is conduct by monopolists or near monopolists; that makes all the difference in the world.[34] The gravamen of the monopolization offense is not that the conduct is unilateral, of course; exclusionary strategies may be implemented by agreement as well as unilaterally. Rather, the essence of the Section 2 offense is conduct by a dominant firm that extends or entrenches its monopoly power "on some basis other than efficiency."[35] There is nothing in the language of the Sherman Act or its legislative history to suggest that Congress thought that monopolistic abuses were less important than concerted action by competitors,[36] or any a priori reason to think that anticompetitive exclusion is less harmful than anticompetitive collusion. To be sure, as a matter of prosecutorial discretion, it may be appropriate for DOJ to make cartel and merger enforcement higher priorities than monopolistic practices. Yet, that does not mean that Section 2 enforcement should be relegated to an enforcement afterthought, or that the agencies should be in the business of persuading courts to adopt permissive standards of exclusionary conduct and to throw out private Section 2 cases. The absence of DOJ on the monopolization beat sends a signal to dominant firms that can only encourage exclusionary conduct, particularly given the financial and legal hurdles that plaintiffs must overcome in successfully prosecuting a private Section 2 action.[37]

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at http://www.usdoj.gov/atr/public/speeches/206428.htm (noting that DOJ's enforcement hierarchy places cartel enforcement at the top, merger enforcement second, and unilateral conduct and other conduct subject to the rule of reason third).

[34] As Justice Scalia has noted, "Where a defendant maintains substantial market power, his activities are examined through a special lens: Behavior that might otherwise not be of concern to the antitrust laws – or that might even be viewed as procompetitive – can take on exclusionary connotations when practiced by a monopolist." Eastman Kodak Co. v. Image Technical Servs. Inc., 504 U.S. 451, 488 (1992) (Scalia, J., dissenting).

[35] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985).

[36] *See generally* Maurice E. Stucke, *Should the Government Prosecute Monopolies?* 2009 ILL. L. REV. (forthcoming 2009), *available at* http://ssrn.com/abstract=1116463. As Professor Stucke notes, the penalties for Section 1 and 2 violations are identical: unlawful monopolization or attempt to monopolize is, like price-fixing, a felony, punishable by fines of up to $100 million for corporations and $1 million for individuals and jail time of up to ten years. Similarly, the legislative history shows that the drafters of the Sherman Act were as concerned – or probably more concerned – with anticompetitive conduct by monopolists as with concerted conduct by competitors. *See id.*

[37] *See* Bonny E. Sweeney, *An Overview of Section 2 Enforcement and Developments*, 2008 WIS. L. REV. 231, 251 (2008) (observing that vast majority of published Section 2 opinions in 2006 and 2007 favored defendants). It is particularly inappropriate for DOJ to abandon the field of Section 2 enforcement while urging the courts to raise the hurdles for private enforcement generally. *See* Restoring the Legitimacy of Private Enforcement, *infra* chapter 6.

B. Tests for Exclusionary Conduct

1. General Tests

The agencies should abandon efforts to promote a single test for exclusionary conduct in all circumstances.

The Supreme Court in *Grinnell* identified two elements for the offense of monopolization: monopoly power ("the possession of monopoly power in the relevant market") and exclusionary conduct ("the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident").[38] In *Aspen Skiing*, the Court defined the conduct element as "behavior that not only (1) tends to impair the opportunities of rivals, but also (2) either does not further competition on the merits or does so in an unnecessarily restrictive way."[39]

Antitrust enforcers, practitioners, judges, and scholars continue to debate the appropriate standard for determining whether a monopolist's conduct is exclusionary (and therefore to be condemned) or competitive (and therefore to be applauded), and whether a single standard is appropriate for all types of monopolization claims.[40] In their certiorari brief in *Trinko*, the DOJ and FTC suggested that a no-economic-sense test was the appropriate standard across the board, whereby conduct is exclusionary if it "would not make economic sense for the defendant but for its elimination or softening of competition."[41] Such a standard, and its cousin, the profit sacrifice test, has been equated with a specific intent test.[42] It has been characterized as a "demanding standard" for plaintiffs,[43] because

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[38] United States v. Grinnell Corp., 384 U.S. 563, 570 – 71 (1966).

[39] *Aspen Skiing*, 472 U.S. at 605 n.32 (quoting AREEDA & TURNER, *supra* note 24, ¶ 626b at 78).

[40] *See, e.g.,* 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.").

[41] Brief for the United States and the Fed. Trade Comm'n as Amici Curiae at 10, Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004) (No. 02-682). In their brief on the merits, the DOJ and FTC retreated somewhat and endorsed a disproportionality test as the general rule, but a no-economic-sense test "in the context of an alleged refusal to assist a rival . . . ." Brief for the United States and the Fed. Trade Comm'n as Amici Curiae Supporting Petitioner 14, 15, *Trinko*, 540 U.S. 398 (2004) (No. 02-682) [hereinafter "U.S. *Trinko* Merits Brief"]. As to refusals to deal with a rival, see the discussion *infra*.

[42] *See* Keith N. Hylton, *The Law and Economics of Monopolization Standards, in* ANTITRUST LAW AND ECONOMICS (K.N. Hylton ed., forthcoming 2009)), *available at* http://ssrn.com/abstract_id=1131250 (April 2008 draft);

in cases of mixed motives, the defendant's conduct would be immunized even if the net effect on consumer welfare was adverse.[44] Yet, the offense of monopolization, as opposed to attempted monopolization, has never required a showing of specific intent,[45] and anticompetitive purpose may be demonstrated by evidence other than that of profit sacrifice.[46] Moreover, *net* consumer welfare is ordinarily the touchstone of antitrust analysis when conduct has both anticompetitive and procompetitive effects.[47]

We agree with commentators who suggest that the test for monopolization should be a flexible one,[48] and that different tests may be appropriate for different categories of conduct, depending in part on the potential costs of false positives and false negatives associated with the type of conduct.[49] However, the best default framework is the consumer-welfare balancing test articulated by the D.C. Circuit in *Microsoft*.[50] The court adopted a rule of reason framework analogous to that used under Section 1, and constructed the following step-by-step analysis: First, the plaintiff may establish a prima facie case by establishing that the challenged conduct has an "anticompetitive effect," i.e.,

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AMC REPORT, *supra* note 21, at 91 ("The test condemns conduct only when its anticompetitive objective is unambiguous . . . .").

[43] U.S. *Trinko* Merits Brief, *supra* note 41, at 17.

[44] While a profit sacrifice or no-economic-sense test is typically justified as a means of preventing false positives, such a test is likely to be more restrictive of monopolists in certain areas such as predatory pricing, which follows a *negative* profit (below cost) standard. *See* Salop, *supra* note 40, at 326.

[45] *See* United States v. Griffith, 334 U.S. 100, 105 (1948); *see, e.g.,* United States v. United Shoe Mach. Corp., 110 F. Supp. 295 (D. Mass. 1953) (monopolist's lease-only policy had certain efficiencies but was condemned as exclusionary because it raised entry barriers and efficiencies could be obtained by less restrictive means), *aff'd per curiam*, 347 U.S. 521 (1954).

[46] *See* Salop, *supra* note 40, at 355 – 56.

[47] *See id.* at 329 – 31.

[48] *See* Herbert J. Hovenkamp, *The Antitrust Standard for Unlawful Exclusionary Conduct* 40 (U. Iowa Legal Stud. Res. Paper No. 08-28, 2008), *available at* http://ssrn.com/abstract=1140346 ("The definition of anticompetitive conduct by the dominant firm must be flexible and not too categorical . . . . Such an approach is appropriate, for anticompetitive strategic behavior by dominant firms comes in many kinds, many of which may not be known or even anticipated today.").

[49] *See, e.g.,* Gavil, *supra* note 22, at 74; Mark S. Popofsky, *Defining Exclusionary Conduct: Section 2, The Rule of Reason, and the Unifying Principle Underlying Antitrust Rules*, 73 ANTITRUST L.J. 435, 437 (2006); Hylton, *supra* note 42, at 2.

[50] United States v. Microsoft Corp., 253 F.3d 34, 58 – 59 (D.C. Cir. 2001).

"harm[s] the competitive *process* and thereby harm[s] consumers."[51] The burden of production then shifts to the monopolist to proffer a "procompetitive justification" for its conduct, that is, "a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal . . . ."[52] If the plaintiff cannot rebut the defendant's procompetitive justification, the plaintiff must then "demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit."[53] The virtue of the *Microsoft* balancing approach, besides its sensible allocation of burdens of proof and its allowance for consideration of both anticompetitive effects and procompetitive benefits, is that it places the focus on actual effects in the marketplace and considers all relevant evidence of the monopolist's strategy. In contrast, the no-economic-sense and profit sacrifice tests focus on the monopolist's intent, but judged solely by evaluating the profitability of the conduct against a hypothetical nonexclusionary benchmark (what profits would be absent any exclusionary effect).

2. Refusals to Deal With a Competitor

The next administration should support *Aspen Skiing* and *Kodak*'s holdings that a monopolist's refusal to deal that results in significant exclusionary effects may be actionable when the monopolist fails to establish a legitimate procompetitive justification.

In their merits brief in *Trinko,* the DOJ and FTC invited the Court to adopt the typically defendant-friendly no-economic-sense test for judging a monopolist's refusal to deal with a rival because of the "infrequent pro-competitive benefits and the frequent anticompetitive risks posed by a generalized requirement that firms assist rivals."[54] While

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[51] *Id.* at 58. Of course, harm to consumers need not be direct or immediate. Indeed, the paradigm of anticompetitive exclusion is that consumers are harmed indirectly and over the long term by the monopolist's maintenance or extension of its monopoly power.

[52] *Id.* at 59.

[53] *Id.* This type of balancing approach has been used by other courts. *See, e.g.*, United States v. Dentsply Int'l, Inc., 399 F.3d 181, 191 – 96 (3d Cir. 2005), and by the FTC. *See In re* Rambus, Inc., FTC Dkt. No. 9302, at 30 – 31 (Aug. 2, 2006), http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf; Majoras, *supra* note 27, at 11 (former chairman of the FTC stating that *Microsoft* was a "sensible 'weighted' balancing approach"). Numerous scholars and practitioners have endorsed such an approach. *See, e.g.*, Salop, *supra* note 40; Gavil, *supra* note 22, at 21 – 23; Jonathan M. Jacobson & Scott A. Sher, "*No Economic Sense" Makes No Sense for Exclusive Dealing*, 73 ANTITRUST L.J. 779, 799 – 800 (2005).

[54] U.S. *Trinko* Merits Brief, *supra* note 41, at 17.

the Court declined the invitation, it was sympathetic to the government's policy arguments and clearly skeptical of refusal-to-deal claims. The AMC also expressed skepticism of refusal-to-deal theories,[55] although its recommendation on this issue – "[i]n general, firms have no duty to deal with a rival in the same market"[56] – hardly seems controversial. Of course a monopolist, like other firms, has a *general* right to refuse to deal with its rivals, but the right is not unqualified.[57] A monopolist's refusal to deal with a competitor that creates significant exclusionary effects should be actionable, as *Aspen Skiing* and *Kodak* suggest, when the monopolist fails to establish a legitimate business justification for the refusal, at least where the monopolist has previously dealt with the competitor or discriminates between the competitor and other customers. Or, as Professor Baker puts it, "a firm with monopoly power violates Sherman Act § 2 if it excludes rivals from the monopolized market by restricting a complementary or collaborative relationship without an adequate business justification."[58]

The essential facilities doctrine should be revitalized.

In addition, the essential facilities doctrine, although treated dismissively by the Court in *Trinko*, ought to be retained and revitalized as an independent theory of liability for purposes of injunctive relief. The courts must recognize that competitor access to infrastructure or networks controlled by a durable monopolist sometimes *is* essential for competition in adjacent markets that produce important public benefits, and that an antitrust remedy may be the most (or only) practical solution to the denial of access.[59]

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[55] AMC REPORT, *supra* note 21, at 101 ("Refusals to deal with horizontal rivals in the same market should rarely, if ever, be unlawful under antitrust law, even for a monopolist.").

[56] *Id.* It is not clear what the AMC intended by its reference to rivals "in the same market." A rival normally means a horizontal competitor in the same market. Perhaps the AMC meant to distinguish monopoly leveraging situations, where the monopolist in one market refuses to deal with a rival in an adjacent market, but that is a common scenario in refusal to deal cases (e.g., *Kodak, Otter Tail,* and *MCI*).

[57] In *Trinko*, the Court, quoting *Colgate*, stated, "as a general matter, the Sherman Act 'does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.'" Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 408 (2004). But, in Orwellian fashion, the Court omitted the preface to the sentence, which reads "In the absence of any purpose to create or maintain a monopoly, . . ." United States v. Colgate & Co., 250 U.S. 300, 307 (1919).

[58] Jonathan B. Baker, *Promoting Innovation Competition Through the* Aspen/Kodak *Rule*, 7 GEO. MASON L. REV. 495, 503 (1999).

The incentives argument for eliminating the essential facilities doctrine or sharply circumscribing liability for refusals to deal – that potential liability will discourage monopolists or their rivals from building facilities in the first place[60] – is overstated and incomplete. Whether a rule that occasionally requires access, subject to reasonable compensation for it, diminishes investment in new facilities in general, or by the monopolist subject to the requirement in particular, cannot be determined by a priori reasoning. It seems at least equally likely that overall investment will increase or remain unchanged because the terms of access can be set to include a monopoly return (at least where the facility is not the product of some unearned advantage), and rivals that depend on access will have *greater* incentives to invest and innovate in complementary markets.[61] Moreover, heightened competition from fringe firms may induce more investment and innovation on the part of the dominant firm.[62]

We do not think separate rules are appropriate for refusals to deal that involve intellectual property.[63] A vertically integrated monopolist's refusal to sell or license its intellectual property to a downstream competitor should be presumptively lawful, but otherwise doctrinally treated the same as a refusal to sell or provide access to physical property.

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[59] *See generally* Brett Frischmann & Spencer Weber Waller, *Revitalizing Essential Facilities*, 75 ANTITRUST L.J. 1 (2008). Insofar as an essential facility is not a natural monopoly, the agencies should keep in mind dissolution as a possible alternative remedy. *See* discussion of remedies *infra*.

[60] *See Trinko*, 540 U.S. at 407 – 08 ("Compelling [monopolists] to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in these economically beneficial facilities."); *see generally* Phillip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles,* 58 ANTITRUST L.J. 841, 851 (1990). For a critique of Areeda's oft-cited article, see Spencer Weber Waller, *Areeda, Epithets, and Essential Facilities*, 2008 WIS. L. REV. 359 (2008)

[61] *See* Frischmann & Waller, *supra* note 59, at 32 - 36; Baker, *supra* note 58, at 512; Brunell, *supra* note 20, at 19 – 20. As for the incentive of the rival to invest in facilities of its own, plainly if the facility can be reasonably duplicated it does not qualify as being "essential," and the very fact that the monopolist has monopoly power in the input market tends to suggest that rivals cannot easily enter that market.

[62] *See, e.g.,* Willard K. Tom, *The 1975 Xerox Consent Decree: Ancient Artifacts and Current Tensions*, 68 ANTITRUST L.J. 967, 978 (2001) (concluding that Xerox compulsory licensing decree "seems to have done a world of good," as competition it induced not only gave consumers better and cheaper products from other suppliers, but forced Xerox to revamp itself and vastly improve the quality of its own offerings).

[63] *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 2.1 (1995) ("The Agencies apply the same general antitrust principles to conduct involving intellectual property that they apply to conduct involving any other form of tangible or intangible property.").

3. Loyalty and Bundled Discounts

The next administration should reject cost-based safe harbors for loyalty and bundled discounts by dominant firms and support a structured rule of reason that would allow plaintiffs to establish that such discounts are prima facie exclusionary under certain conditions.

Loyalty and bundled discounts or rebates are agreements under which a seller provides a "discount" to a buyer that agrees to purchase some high percentage of its requirements for a particular product from the seller (a loyalty discount) or to purchase a second product from the seller (a bundled discount). As Professor Elhauge notes, "[l]oyalty and bundled discounts raise anticompetitive concerns similar to those raised by exclusive dealing and tying agreements,"[64] primarily the foreclosure of rivals. Like exclusive dealing and tying practices, loyalty and bundled discounts should be unlawful when they help preserve or extend a dominant firm's market power and the exclusionary conditions are not justified by a countervailing procompetitive benefit. This is essentially the standard adopted by the Third Circuit in *LePage's*.[65]

The AMC criticized the *LePage's* standard as being "too vague and . . . therefore likely to chill welfare enhancing bundled discounts or rebates."[66] The AMC and others have argued that bundled discounts should be treated like predatory pricing and subject to a cost-based safe harbor, largely on the premise that such discounts typically benefit consumers; a cost-based safe harbor would protect against false positives and also provide certainty to businesses considering these practices.[67] In particular, the AMC and

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[64] EINER ELHAUGE, UNITED STATES ANTITRUST LAW AND ECONOMICS 408 (2008). It is worth noting that Section 3 of the Clayton Act, which condemns tying and exclusive dealing contracts where the effect "may be to substantially lessen competition or tend to create a monopoly," includes conditional discounts and rebates within its ambit.

[65] LePage's Inc. v. 3M Co., 324 F.3d 141 (3d Cir. 2003).

[66] AMC REPORT, *supra* note 21, at 97.

[67] DOJ and FTC recently asserted, "Clear and administrable standards are needed to enable firms to know in advance if bundled discounting that they are considering may subject them to antitrust liability. The development of clear, administrable standards for analyzing bundled discounts would be furthered by use of an appropriate price-cost safe harbor." U.S. Submission for OECD Roundtable on Bundled and Loyalty Discounts and Rebates 9 (July 1, 2008), *available at* http://www.usdoj.gov/atr/public/international/234014.pdf [hereinafter U.S. Submission]. Yet in its certiorari brief in *LePage's* the government asserted that there was no pressing need for the Supreme Court to address the matter because "[w]hile bundled rebates may be a common business practice, it is not clear that monopolists commonly bundle rebates for products over which they have monopolies with products over which they do not." Brief for the United States as Amicus Curiae, *LePage's*, *supra* note 12, at 19.

the recent Ninth Circuit decision in *PeaceHealth*[68] have put forward a discount attribution rule under which such discounts would be immunized from antitrust scrutiny if the price of the "competitive" product is above the defendant's incremental cost of production, after attributing the full amount of the discounts to the competitive product.[69]

The next administration should not support cost-based safe harbors for loyalty discounts or bundled discounts by dominant firms. As an initial matter, it may be a misnomer to refer to bundled or loyalty pricing structures as "discounts." Rather, these practices may often be better understood as imposing "penalties" for failing to comply with the exclusionary conditions. Alternatively, as Professor Elhauge points out, "Rather than call them either loyalty discounts or disloyalty penalties, it would be more neutral to call them price differences conditioned on exclusionary conditions, because an important question is precisely whether the prices charged to those who refuse to abide by those conditions are above but-for prices (in which case they are really penalties) or below but-for prices (in which case they are really discounts)."[70] But even if the "discount" is a true discount,[71] the predatory pricing analogy is inapt because the conduct at issue is not discounting, as such, but the exclusionary conditions that accompany the discounting.[72]

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[68] Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007).

[69] *See id.* at 914 – 20; AMC REPORT, *supra* note 21, at 99. The AMC also would require a plaintiff to show a likelihood of recoupment and an adverse effect on competition (as well the other elements of a Section 2 violation) in order to prevail. The Ninth Circuit rejected a recoupment requirement as inappropriate (because exclusionary bundling can be profitable in the short run) and "an adverse effect on competition" requirement as redundant. *See PeaceHealth*, 502 F.3d at 921 n.21.

[70] ELHAUGE, *supra* note 64, at 406. Similarly, with respect to bundled discounts, if the price of the unbundled products is higher than it would have been without the "discount" program, then the discount amounts to a penalty. *See id.* at 409 ("[C]onsumer welfare will be harmed without any substantial foreclosure, as long as the standalone price exceeds the but-for independent monopoly price, unless there are offsetting efficiencies.").

[71] It may be difficult to tell whether the "discount" is a true discount or a penalty, because the but-for price may not simply be the price before the program was implemented where, for example, costs are declining or the dominant firm's market power is eroding. *See id.* at 414. Moreover, the discounts, if in the form of lump sum rebates, may not benefit ultimate consumers because they do not lower the intermediate purchaser's marginal costs. *See* Barry Nalebuff, *Exclusionary Bundling*, 50 ANTITRUST BULL. 321, 347 (2005) (explaining that lump sum rebate is less likely to be passed on to consumers and may be particularly anticompetitive when the products in the bundle are substitutes). Bundled discounts also reduce transparency in pricing and make it difficult for buyers to comparison shop. *See id.* at 322 ("buyers find it difficult to compare a bundled price with a la carte offerings").

[72] *See* Brief for the United States as Amicus Curiae, *LePage's*, *supra* note 12, at 12 ("[T]he bundling of rebates (as distinct from price reductions that may result) is not necessarily procompetitive."); ELHAUGE, *supra* note 64, at 413 ("Such conditions create anticompetitive problems that are not raised by mere low pricing. They

While straightforward discounting is unambiguously good for consumers (at least in the short term), exclusionary conditions are not; indeed, if bundling itself were attractive to consumers, one would expect the bundled products to be sold at a premium, not a discount. Thus, a fear of false positives does not justify a demanding test based on the reasoning of *Brooke Group*.[73] Restrictions on dominant firm use of bundled or loyalty discounts do not restrict dominant firms from offering unconditional discounts or uniform volume discounts.

Cost-based safe harbors are also problematic because "cost-based tests are notoriously hard to administer."[74] Additionally, the discount attribution rule endorsed by the AMC and *PeaceHealth*, by using the dominant firm's costs as the relevant standard, bars only those exclusionary discounts that would foreclose an equally efficient rival; it would allow a dominant firm to exclude a less efficient rival that constrained the dominant firm's pricing[75] and that might have become equally (or more) efficient absent the exclusion.[76]

Nevertheless, while a cost-based test should not be used as a safe harbor, a discount attribution rule may be employed by plaintiffs as one way to establish that bundled discounts have an exclusionary effect, which should shift the burden to the defendant to provide a procompetitive justification.[77] More generally, the administration should

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discourage discounting to unconditioned buyers. Loyalty conditions attached to low prices prevent rivals from winning sales by matching prices one purchase at a time, but instead require the rival to be able to replace all the units a purchaser has, which may be difficult, especially if some of the purchases are hard to contest . . . . Bundled discounts in addition require rivals to overcome discounts on other products.").

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

[74] ELHAUGE, *supra* note 64, at 413.

[75] *Cf.* Salop, *supra* note 40, at 328 ("The fundamental problem with applying the equally efficient entrant to [raising rivals' costs] conduct is that the unencumbered (potential) entry of less-efficient competitors often raises consumer welfare.").

[76] *See* ELHAUGE, *supra* note 64, at 412 ("Rivals that are equally efficient (in the sense of having a long run cost curve that is as low as the defendant) might be unable to achieve a price as low as the defendant's costs precisely because the foreclosure has relegated them to the high cost portion of their cost curve."); *cf.* LePage's Inc. v. 3M Co., 324 F.3d 141, 161 (3d Cir. 2003) (as a result of 3M's rebate program "LePage's manufacturing process became less efficient and its profit margins declined").

[77] In its recent submission to the Organisation for Economic Co-operation and Development supporting a cost-based safe harbor, the current administration maintained that the failure to come within the safe harbor should not create a presumption of anticompetitive effects. *See* U.S. Submission, *supra* note 67, at 9. The administration suggested that the appellate case law supported a cost-based test for loyalty discounts, citing then Judge Breyer's exposition on predatory pricing in Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d

advocate a structured rule of reason for bundled discounts that would permit a single-product plaintiff to establish that a multiproduct monopolist's bundled discount or rebate program is prima facie exclusionary by showing: (1) the price of defendant's competitive product, when all discounts on the product bundle are allocated to that product, is below defendant's incremental cost of producing it; (2) the "allocated" price is below the *plaintiff's* cost of production and is likely to have an adverse effect on competition; (3) the product bundle amounts to a de facto tying arrangement;[78] (4) the prices of unbundled products are higher than the prices were or would have been in the absence of the bundling program; or (5) the bundling program otherwise resulted in foreclosure of a significant part of the market for the competitive product. To rebut the plaintiff's prima facie case, a dominant firm would be required to establish a legitimate business or efficiency justification for conditioning the discount. This in turn would shift the burden of proof to the plaintiff to demonstrate that the anticompetitive effects of the exclusionary condition outweigh any of its procompetitive benefits.

Conditional loyalty rebates that are granted on all purchases made once a certain threshold is reached (first-dollar discounts) are highly susceptible to exclusionary effects.[79] Therefore, these rebates should be considered prima facie exclusionary when used by a dominant firm, subject to rebuttal by the defendant that the actual foreclosure

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227 (1st Cir. 1983). However, while *Barry Wright* did involve a loyalty discount, the plaintiff challenged the discount as predatory pricing and separately as exclusive dealing, and Judge Breyer pointedly did not apply a cost test to the exclusive dealing theory.

[78] The Ninth Circuit left open the possibility that a plaintiff that did not satisfy its discount attribution rule may still be able to establish a tying violation based on the discount. *See* Cascade Health Solutions v. PeaceHealth, 502 F.3d 895, 929 n.30 (9th Cir. 2007). While some commentators have suggested that the coercive element of tying cannot be established without satisfying the discount attribution rule, others have suggested that separate sales of less than 10% presumptively indicate a de facto tie. *See* 10 PHILLIP E. AREEDA ET AL., ANTITRUST LAW ¶ 1758b (1996). Insofar as tying doctrine is concerned primarily about foreclosure and the impairment of competition on the merits, a high degree of coercion should not be required to make a package discount by a monopolist presumptively unlawful. *See, e.g.,* N. Pac. Ry. Co. v. United States, 356 U.S. 1 (1958) (preferential routing clause held to be an unlawful tying arrangement notwithstanding that customers were not bound when the tied product was available on better terms elsewhere); *cf.* ELHAUGE, *supra* note 64, at 410 – 11 (suggesting that treating any price penalty as foreclosing is consistent with tying doctrine, which focuses on market distortion).

[79] *See* Robert H. Lande, *Should Predatory Pricing Rules Immunize Exclusionary Discounts?*, 2006 UTAH L. REV. 863, 876 – 80 (2006) (noting that such discounts may involve negative prices); European Comm'n, DG Competition, *Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses* ¶ 152, at 44 (2005), *available at* http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf ("Conditional rebates that are granted on all purchases in the reference period once a certain threshold is exceeded can have a strong foreclosure effect.").

effect is minimal or that there is a legitimate business or efficiency justification for the retroactive form of the discount that outweighs its anticompetitive effect.

4. Predatory pricing

The next administration should look for opportunities to bring predatory pricing cases and encourage courts to develop a structured rule of reason that is more consistent with modern economic thinking about predatory pricing strategies than is current law.

The Supreme Court's observation in *Matsushita*,[80] repeated in *Brooke Group*,[81] that "there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful," is manifestly out of touch with modern economic scholarship and should be retired.[82] The agencies should look for opportunities to bring predatory pricing cases, and encourage courts to pay more attention to the plausibility of the alleged predatory scheme and the incremental costs and revenues associated with the scheme. The agencies should also suggest a structured rule of reason that would relax the evidentiary requirements for recoupment and below-cost pricing when the plaintiff presents strong evidence that defendant's conduct conformed to a plausible predatory strategy.[83]

C. Monopolization Remedies

The agencies should seek to employ structural remedies in appropriate cases, give more serious consideration to equitable monetary remedies, and support legislation to allow both agencies to obtain civil penalties in Section 2 cases.

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[80] Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 589 (1986).

[81] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 226 (1993).

[82] *See* Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L. J. 2239, 2241 (2000) (explaining that "modern economic analysis has developed coherent theories of predation that contravene earlier economic writing claiming that predatory pricing conduct is irrational" and that "the consensus view in modern economics [is] that predatory pricing can be a successful and fully rational business strategy"); *see, e.g.,* Spirit Airlines, Inc. v. Northwest Airlines, Inc., 431 F.3d 917 (6th Cir. 2005) (reversing summary judgment for defendant on predatory pricing complaint).

[83] That is the gist of the structured rule of reason proposed by Bolton, Brodley & Riordan, *supra* note 82, at 2262 – 74. Too often courts get bogged down in the minutiae of determining whether prices are below defendant's average variable costs, while losing sight of the evidence that a monopolist in fact adopted a successful predatory strategy to eliminate or chasten a rival. *See, e.g.,* United States v. AMR Corp., 335 F.3d 1109 (10th Cir. 2003).

An appropriate remedy in a Section 2 case should "terminate the illegal monopoly, deny to the defendant the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future."[84] In *Microsoft*, the most significant monopolization case in the last twenty years, the consent judgment ultimately obtained by DOJ[85] utterly failed to achieve these remedial goals or have any effect whatsoever on the monopolized market.[86] But beyond *Microsoft*, it is widely perceived that behavioral or conduct remedies frequently do little to change the operation of markets, may create perverse incentives, are difficult to administer, and often amount to no more than a slap on the wrist.[87] Given the difficulties and poor track record of conduct remedies, it makes sense for the agencies to give more consideration to structural relief – including dissolution – which, after all, is the preferred remedy in merger cases,[88] and is the most direct means of restoring competition in a market.[89] And

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[84] United States v. United Shoe Mach. Corp., 391 U.S. 244, 250 (1968); *see also* United States v. Microsoft Corp., 253 F.3d 34, 103 (D.C. Cir. 2001) (adding that remedy "must seek to 'unfetter a market from anticompetitive conduct'") (quoting Ford Motor Co. v. United States, 405 U.S. 562, 577 (1972)).

[85] DOJ and State plaintiffs originally requested and obtained a structural remedy that would have required Microsoft to divest its operating systems business from its applications business, but the D.C. Circuit reversed the district court's remedial order. Following a change in administrations, DOJ negotiated a consent decree limited to behavioral requirements. *See generally* First & Gavil, *supra* note 14.

[86] *See* HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE 298 (2005) ("At this writing, there is little reason to believe that the consent decree that the government negotiated with Microsoft will achieve any of [the] goals [stated by the D.C. Circuit]. If so, the *Microsoft* case may prove to be one of the great debacles in the history of public antitrust enforcement, snatching defeat from the jaws of victory."); Carl Shapiro, *Microsoft: Remedial Failure*, 75 ANTITRUST L.J. (forthcoming 2008) (Dec. 18, 2007 manuscript at 17), *available at* http://faculty.haas.berkeley.edu/shapiro/microsoft2008.pdf ("The Final Judgment has done nothing significant to affirmatively restore competition. The remedy in the most prominent antitrust case of our era has failed."); First & Gavil, *supra* note 14, at 707 ("There is little surprise that the decree . . . will make no dent in Microsoft's power, or even in its fundamental business practices.").

[87] *See* Einer Elhauge, *Disgorgement as an Antitrust Remedy*, 76 ANTITRUST L.J. (forthcoming 2009) (May 2008 manuscript at 9 – 10), *available at* http://papers.ssrn.com/abstract_id=1136945; Thomas O. Barnett, Ass't Att'y Gen., Antitrust Div., U.S. Dep't of Justice, What to Do After Catching the Tiger by the Tail, Presentation at the ABA Conference on Monopolization Remedies 3 (June 4, 2008), *available at* http://www.usdoj.gov/atr/public/speeches/233884.pdf ("It is not easy to craft what is typically a behavioral remedy that will achieve its desired objectives, avoid unintended harm, and be administrable.").

[88] *See* U.S. DEP'T OF JUSTICE, ANTITRUST DIV., POLICY GUIDE TO MERGER REMEDIES 7 (2004) ("Structural remedies are preferred to conduct remedies in merger cases because they are relatively clean and certain, and generally avoid costly government entanglement in the market."), *available at* http://www.usdoj.gov/atr/public/guidelines/205108.pdf.

[89] See Peter C. Carstensen, *False Positives in Identifying Liability for Exclusionary Conduct: Conceptual Error, Business Reality and* Aspen, 2008 WIS. L. REV. 295, 328 (2008) ("[I]f there were a legitimate concern that conduct-oriented decrees impose unreasonable risks to economic efficiency and desirable market dynamics, then

structural relief has had notable successes in Section 2 cases, including the breakup of AT&T during the Reagan administration.[90] While caution is certainly warranted in imposing structural remedies in monopoly cases, even in cases of systematic anticompetitive conduct, the current DOJ position that such remedies are almost never appropriate is not justified.[91]

In order to deter monopolistic abuses, monetary sanctions in government monopolization cases should also be given more consideration. Professor Calkins has noted that "we have a strange system for punishing persons who commit civil antitrust violations."[92] In contrast to the European Union and many other foreign jurisdictions where the civil fine is the tool choice, in the United States,

> a federal government civil enforcement action typically ends with an injunction, usually by consent, that prevents future violations, and it is

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because monopoly itself is bad, it may be a good idea to refocus monopoly law on its traditional mission of eliminating monopoly and restoring workably competitive markets.").

[90] In United States v. Am. Tel. & Tel. Co., 552 F. Supp. 131 (D.C. Cir. 1982), *aff'd sub nom.* Maryland v. United States, 460 U.S. 1001 (1983), the court approved the divestiture of the local Bell operating companies to remedy AT&T's monopolization of the long-distance and equipment markets. In ordering this structural remedy, the court commented that it would be difficult to draft a conduct-remedy injunction "that would be both sufficiently detailed to bar specific anticompetitive conduct yet sufficiently broad to prevent the various conceivable kinds of behavior that AT&T might employ in the future" and that it was preferable to avoid burdening the judiciary with "the unending task of vigilance and oversight" required for such a complex conduct remedy. *Id.* at 168. Of course, the court's rejection of strict line of business restrictions on the operating companies sought by DOJ resulted in the kind of regulatory oversight by the court that the divestitures were designed to avoid.

[91] *See* Barnett, *supra* note 87, at 16 (structural relief "rarely justified"). In *Microsoft*, the D.C. Circuit, while recognizing that "divestiture is a common form of relief in successful antitrust prosecutions" and is "indeed 'the most important of antitrust remedies,'" 253 F.3d at 105 (quoting United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316 (1961)), seemed to require a tight causal nexus between Microsoft's exclusionary conduct and its monopoly position in the operating systems market to justify structural relief. *See id.* at 106 – 07. This requirement is hard to explain if the purpose of the divestiture is remedial, i.e., is necessary to prevent the recurrence of the anticompetitive conduct, rather than punitive, and is particularly inexplicable in *Microsoft* given that the divestiture would not have dissolved Microsoft's operating system monopoly. While opponents of structural relief often view corporations anthropomorphically (referring to divestiture as the corporate "death penalty") or zoomorphically, *see* Barnett, *supra* note 87, at 10 ("unless you have established that the tiger should never have existed in the first instance, you have not established a basis for shooting it"), a sober analysis suggests that corporate divestiture is a common "tool of the business world and can be used to further public policy just as it is used to further corporate ends." Carstensen, *supra* note 89, at 319 – 20 (rejecting corporate death penalty analogy "[g]iven the flexibility of the market to structure and restructure corporate organizations").

[92] Stephen Calkins, *Civil Monetary Remedies Available to Federal Antitrust Enforcers*, 40 U.S.F. L. REV. 567, 570 (2006).

> assumed that private and state damages actions will extract sufficient money from the wrongdoer to compensate victims and adequately deter other violations. The government plays the role of the volleyball setter, leaving for others the more glamorous (and lucrative) spiking.[93]

However, as Professor Elhauge points out, "the adequacy of private actions seems increasingly dubious, especially in monopolization cases."[94] Private lawsuits generally provide insufficient deterrence in Section 2 cases because excluded competitors, even if they succeed, can recover only their lost profits, which will be less than any monopoly overcharges incurred by direct or indirect purchasers,[95] and purchaser or consumer actions must surmount many hurdles (e.g., standing, antitrust injury, and class certification).[96] Moreover, perhaps the most pernicious effect of monopolistic conduct – the exclusion of potential entrants and retarding the pace of innovation – cannot be readily measured and thus compensated in private actions.

Given the inadequacies of other remedies in Section 2 cases, a number of commentators have advocated that the government make greater use of monetary equitable remedies (disgorgement and restitution) or that civil penalties be added to the enforcers' Section 2 arsenals.[97] The advantage of equitable monetary remedies is that the agencies currently have the authority to seek such relief, although the Justice Department has never done so

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[93] *Id.*

[94] *See* Elhauge, *supra* note 87, at 5.

[95] *See id.* at 7 (noting that "any rival claim will be limited to the competitive profits the rival could have earned on some share of the market in the but-for world").

[96] *See* Calkins, *supra* note 92, at 571 ("The requirements that private plaintiffs surmount the rigorous hurdles of proving standing and antitrust injury (as well as the other elements of their cases), when added to the commercial realities of business, make quite real the possibility that an antitrust violation will go without private punishment."); *see generally* Restoring the Legitimacy of Private Enforcement, *infra* chapter 6.

[97] *See* Elhauge, *supra* note 87 (advocating greater use of disgorgement remedy); Harry First, *The Case for Antitrust Civil Penalties*, 76 ANTITRUST L.J. (forthcoming 2009) (advocating civil penalty authority for DOJ and FTC for use in monopolization cases that involve systematic conduct to maintain a monopoly, as in *Microsoft*, or conduct where there is no plausible efficiency justification); Calkins, *supra* note 92 (strongly supporting FTC authority to obtain monetary equitable relief and advocating that serious consideration be given to the DOJ using its current disgorgement authority and to enacting legislation authorizing both agencies to impose civil fines for substantive violations). Both agencies currently have the authority to impose civil penalties for certain procedural violations. *See* AMC REPORT, *supra* note 21, at 285.

and the FTC has done so only sparingly.[98] Authority to impose civil penalties would require a legislative change, but a civil penalty has the distinct advantage of being available when the monopolist has not succeeded in causing harm (e.g., a failed attempt to monopolize), or where the full extent of the harm it caused is difficult to prove. Moreover, civil penalties could underscore the seriousness with which the government views the offense and hence serve as an important deterrent in a way that disgorgement of ill-gotten gains, restitution, or treble damages cannot.[99] In contrast, a toothless conduct remedy for a pattern of anticompetitive conduct, as in *Microsoft*, may do more to undermine general deterrence than not bringing the case in the first place.[100]

The AMC endorsed the FTC's policy statement on monetary equitable remedies,[101] and we agree that the factors set forth in the statement are appropriate factors to consider in a Section 2 case, i.e., whether the violation is clear; whether there is a reasonable basis for calculating the remedy, and whether the remedy would add value in light of other remedies available in the matter.[102] However, for the reasons noted above, these factors suggest that equitable monetary relief should be less exceptional in Section 2 cases than the policy statement may indicate.[103] The AMC rejected calls to give the agencies

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[98] *See* AMC REPORT, *supra* note 21, at 286 (noting that only the FTC has exercised its implied authority to seek monetary equitable remedies, and then only in 11 antitrust cases in the past 26 years).

[99] *See* First, *supra* note 97, at 23 ("[A] civil fine might be used to underline the serious harm from monopolizing conduct in a way that is unavailable to prosecutors today.").

[100] To be sure, Microsoft ended up paying roughly $5 billion to settle the private actions arising from the government's case. *See* Todd Bishop's Microsoft Blog, http://blog.seattlepi.nwsource.com/microsoft/archives/104794.asp (July 7, 2006). While this figure isn't peanuts, it merely amounts to about 10% of Microsoft's operating income during the four-year period of the payouts (2003 – 06) and likely was tax deductible. *See* First, *supra* note 97, at 23 – 24 (noting that civil fines provide more deterrence, dollar-for-dollar, than damages awards because fines are not tax deductible).

[101] *See* AMC REPORT, *supra* note 21, at 288 (recommendation 49). The AMC expressed concern that such relief not result in "duplicative recoveries," but noted that in the "thirty years since the FTC first exercised its equitable authority, there has never been a duplicative recovery." *Id.* We agree that duplicative recoveries for the same harm should be avoided, but by the same token, equitable monetary relief should not result in a reduction of overall recoveries that would be available to private plaintiffs in the absence of disgorgement or restitution.

[102] *See* Fed. Trade Comm'n, Policy Statement on Monetary Equitable Remedies in Competition Cases, 68 Fed. Reg. 45,820 (Aug. 4, 2003).

[103] *See id.* at 45,821 ("[W]e do not view monetary disgorgement or restitution as routine remedies for antitrust cases. In general, we will continue to rely primarily on more familiar, prospective remedies, and seek disgorgement and restitution in exceptional cases."); *see also* AMC REPORT, *supra* note 21, at 288 (commending the FTC's "limited" and "judicious" use of remedy). Professor Elhauge maintains that "going

expanded authority to seek civil fines, on the basis that it did not receive evidence of "significant gaps in the current level of enforcement provided by private plaintiffs seeking damages," and that to the extent any gaps remain, "they are better addressed through the use of the agencies' equitable powers . . . ."[104] However, the AMC itself noted the gap where monopolists engage in egregious conduct that results in no injury (which would not be subject to equitable monetary relief)[105] and failed to recognize both the range of cases in which the recoverable harm is likely to be small in relation to the actual or potential harm and the deterrent advantage of civil penalties over equitable monetary relief. In sum, increased use of equitable monetary remedies and authority for civil fines would both be useful additions, for, as Professor First notes, "Given the low level of government monopolization cases, and the difficulties of private litigation, one would be hard-pressed to argue that current penalties are adequately deterring corporations from violating Section 2."[106]

II. Other Exclusion Issues

A. Exclusive Dealing

The agencies should help sharpen the analysis of exclusive dealing arrangements. Whether viewed under Section 2 or Section 1, exclusive dealing arrangements should be analyzed under the same analytical framework, although the degree of required foreclosure may vary with the degree of market power possessed by the firm protected

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by the FTC's own statement of the relevant factors, it would seem that those factors now call for increased usage of disgorgement claims, given the increasing inadequacy of private claims for monetary relief . . . ." Elhauge, *supra* note 87, at 7 – 8.

[104] AMC REPORT, *supra* note 21, at 287 – 88.

[105] The AMC cited unsuccessful solicitations to collude as an example of a gap, but said that egregious cases without antitrust injuries "are rare and do not, by themselves, provide sufficient reason to expand the agencies' civil fine authority." *Id.* at 288. Even if monopolization and attempted monopolization without significant injury were rare, it is not apparent why the agencies should not have civil fine authority at least for those supposedly rare cases.

[106] First, *supra* note 97, at 23. Professor Elhauge argues that one of the factors that may be inhibiting DOJ from bringing cases in the first place is that it has no useful remedy to obtain. *See* Elhauge, *supra* note 87, at 11 ("disgorgement may be the remedy that offers a potential cure for the current paralysis of DOJ enforcement in monopolization cases"). *Cf.* Barnett, *supra* note 87, at 7 ("[I]t is critical to think hard about what you are going to do with the tiger before you grab its tail. If you cannot do something constructive, you should consider not grabbing it in the first place.").

by the exclusive dealing agreement.[107] As a general matter, an exclusive dealing arrangement by a dominant supplier to restrict its customers from dealing with rival suppliers, or by a dominant distributor to restrict its suppliers from dealing with rival distributors, raises sufficient competitive risks to require justification by the dominant firm, without a showing of a high degree of market foreclosure. An exclusive dealing arrangement involving firms that are not monopolists or near-monopolists could be prima facie unlawful under Section 1 where rivals are significantly foreclosed from needed inputs or outlets, subject to rebuttal by the defendant that the agreement serves procompetitive purposes.[108]

B. Tying

The next administration should support the retention of the current modified per se rule for tying, with certain caveats.

The current modified, or quasi, per se rule for tying, as articulated in *Jefferson Parish*,[109] should be retained with the caveats that: (1) courts should expressly allow a defendant to establish a defense that an otherwise unlawful tying arrangement has a procompetitive justification that cannot be adequately furthered by a less restrictive alternative and that offsets any anticompetitive harm;[110] and (2) requirements ties are suspect because they are often imposed for purposes of anticompetitive price discrimination.

In *Illinois Tool Works*,[111] the Supreme Court addressed tying conduct involving the sale of a patented ink jet printhead and the requirement that all ink used in the printhead be

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[107] Numerous cases hold that an exclusive dealing arrangement may violate Section 2 even though it does not violate Section 1. *See, e.g.,* United States v. Microsoft Corp., 253 F.3d 34, 70 (D.C. Cir. 2001); U.S. v. Dentsply Int'l, Inc., 399 F.3d 181, 197 (3d Cir. 2005). These results appear to be an artifact of the requirement that an exclusive dealing arrangement must foreclose a substantial share of the market to competitors to violate Section 1, whereas foreclosure under Section 2 need not be as significant to preserve a dominant firm's monopoly power.

[108] This means that "naked" exclusionary agreements could be unlawful under Section 1 without a showing that the defendant has market power. *See* A. Douglas Melamed, *Exclusive Dealing Agreements and Other Exclusionary Conduct – Are There Unifying Principles*?, 73 ANTITRUST L.J. 375, 406-10 (2006) (arguing that an exclusive dealing agreement that materially diminishes a rival's competitive efficacy should require justification, even in the absence of a showing of market power).

[109] Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984).

[110] This "defense" has been considered in many Supreme Court cases, but has never been expressly recognized or satisfied. *See, e.g., Jefferson Parish*, 466 U.S. at 25 n.42.

[111] Ill. Tool Works Inc. v. Indep. Ink, Inc., 547 U.S. 28 (2006).

purchased from a source approved by the patentee. Overturning precedent, the Court held that the plaintiff's tying claim was not entitled to a market power presumption based on the patented status of the tying product. The holding was narrow, but the Court offered dicta that "[m]any tying arrangements, even those involving patents and requirements ties, are fully consistent with a free, competitive market."[112] That statement and the Court's holding have invited some commentators to urge abandoning the modified per se rule governing ties.[113]

Jefferson Parish's modified per se rule is in fact a structured rule of reason, precisely the type of structured review that is needed to guide courts and attorneys to results that are consistent with sound antitrust policy. A rule of reason analysis that would require a plaintiff to demonstrate, in addition to the *Jefferson Parish* factors, a significant foreclosure in the tied product market is unnecessary given the typical harm to consumers in the tying product market.[114] Indeed, for some types of tying, a tightening of current standards is called for, which would lead to just results at lower overall costs to the litigants and court system. A case in point is the requirements tie-in that was at issue in *Illinois Tool Works*. Requirements ties, or metered ties, involve the sale of a tied product that is complementary to the tying product and purchased in direct proportion to the tying product's use. Thus, the ink used in a printhead would be a direct measure of the use of the printhead itself. By setting a supracompetitive price on tied sales of the ink, the tying seller is able to engage in price discrimination – charging intensive users of the tying product a higher fee for the bundled products than would be exacted from less intensive users.

Some scholars have defended this price discrimination as a way in which the seller can simultaneously more efficiently allocate the tying product (setting a low price that widens distribution) while increasing overall return. It has also been argued that this higher overall return is a way of fostering innovation in tying product markets involving

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112 *Id.* at 45.

113 *See, e.g.,* David S. Evans, Untying the Knot: The Case for Overruling *Jefferson Parish* (July 2006), *available at* http://www.usdoj.gov/atr/public/hearings/single_firm/comments/219224_a.pdf.

114 *See* ELHAUGE, *supra* note 64, at 350 – 58.

intellectual property.[115] However, other scholarship suggests that requirements ties are often anticompetitive.[116] Indeed, Congress enacted Section 3 of the Clayton Act against the backdrop of dissatisfaction with an early Court decision that tolerated a requirements tie.[117] Over the past century the Supreme Court has condemned requirements ties in a variety of settings.[118] The perfect price discrimination that is required for a more efficient allocation of the tying product is impossible to achieve in many real world markets in which neither buyer nor seller has perfect knowledge. And in any event, the Supreme Court considers facilitation of price discrimination to be an anticompetitive use of market power.[119]

The deferred purchase of the tied product often works special burdens on the buyers who will not know their own needs and the market conditions at the time of future purchases. Buyers' lack of knowledge and confusion may make it easier for a seller to implement metering through a tie-in (rather than through a direct metering mechanism that is unpalatable to buyers), but this cannot justify the tying conduct. Even if imperfect price discrimination were to increase sales of the tying product, wealth transfer effects may harm intensive users, who might also reduce their use of the bundled products because of the excessive charges. In addition, buyers may expend additional resources in search of lower cost alternative suppliers or ways to avoid the tying condition. Finally, if metered pricing is in fact an efficient way to market a product, that metering can often be achieved through a direct metering mechanism that avoids the potential for anticompetitive effects of a requirements tie.

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115 *See* Benjamin Klein & John Shepard Wiley, Jr., *Competitive Price Discrimination as an Antitrust Justification for Intellectual Property Refusals to Deal*, 70 ANTITRUST L.J. 599 (2004) (arguing that licensing restrictions and tying conduct involving intellectual property should be treated leniently because of the innovation gains that they are likely to bring).

116 *See* Barry Nalebuff, *Unfit to be Tied, An Analysis of* Trident v. Independent Ink, *in* THE ANTITRUST REVOLUTION: ECONOMICS, COMPETITION & POLICY (John Kwoka & Lawrence White eds., 5th ed. 2008), *available at* http://ssrn.com/abstract=1004087; Warren S. Grimes & Lawrence A. Sullivan, Illinois Tool Works, Inc. v. Independent Ink, Inc.: *Requirements Tie-ins and Intellectual Property*, 13 SW. J. L. & TRADE AM. 335 (2007).

117 *See* Grimes & Sullivan, *supra* note 116, at 344.

118 See the cases cited in Grimes & Sullivan, *supra* note 116, at 344 n.55. As Grimes & Sullivan also note, requirements tying has also been condemned under European competition law. *See id.* at 344.

119 *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 14 – 15 & n.23 (1984) ("impairment of competition" from tying includes "inceas[ing] the social costs of market power by facilitating price discrimination, thereby increasing monopoly profits over what they would be absent the tie").

These and related concerns have led scholars to advocate a low-tolerance antitrust standard for requirements tie-ins. Nalebuff and Grimes & Sullivan, for example, urge that a presumption of market power attach to the use of requirements ties.[120] While *Illinois Tool Works* would appear to foreclose such a rule, the Supreme Court did acknowledge that "price discrimination may provide evidence of market power . . . ."[121] Accordingly, in assessing market power in cases of requirements ties used for metering, the *Jefferson Parish* standard should account for the long-recognized reality that requirements ties may often have substantial anticompetitive consequences.

C. Kodak*, Market Power and Aftermarkets*

The next administration should recognize that information deficiencies and other "consumer protection" market imperfections may give a firm market power, regardless of conventional market share analysis, and may make markets susceptible to opportunistic conduct with exclusionary and other anticompetitive effects.

The enforcers and the courts should embrace *Kodak*'s[122] post-Chicago insights into how markets characterized by significant information imperfections, post-purchase switching costs, and related factors may be particularly susceptible to opportunistic conduct with exclusionary and other anticompetitive effects. These insights should be applied more liberally to protect competition in aftermarkets, but perhaps more importantly, can contribute generally to the sound evolution of Section 2 law and vertical restraints in a potentially broad array of market spaces beyond the aftermarket context in which *Kodak* case law has developed to date.[123]

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[120] *See* Nalebuff, *supra* note 116, at 3 (price discrimination through metered ties "should be viewed as evidence of market power"); Grimes & Sullivan, *supra* note 116, at 354 (concerns with requirements ties are "ample to warrant a rebuttable presumption of power in the tying product when a required complementary good is tied in order to accomplish metered differential pricing").

[121] *Illinois Tool Works*, 547 U.S. at 44-45 (rejecting rebuttable presumption of market power for patented tying products used to effect a requirements tie because price discrimination "also occurs in fully competitive markets").

[122] Eastman Kodak Co. v. Image Technical Servs., 504 U.S. 451 (1992).

[123] *See* Robert H. Lande, *Market Power Without a Large Market Share: The Role of Imperfect Information and Other "Consumer Protection" Market Failures* (AAI, Working Paper No. 07-06, 2007), *available at* http://www.antitrustinstitute.org/Archives/wp07-06.ashx; Robert H. Lande, *Chicago Takes it on the Chin: Imperfect Information Could Play a Crucial Role in the Post-*Kodak *World*, 62 ANTITRUST L.J. 193 (1993).

Kodak recognizes that information deficiencies and other "consumer protection" market imperfections (such as deception and coercion) may give a firm market power, regardless of conventional market share analysis.[124] Moreover, *Kodak* implicitly recognizes that "consumer protection" market failures can apply to businesses as well as individual consumers. Where significant information or other market imperfections exist, therefore, the agencies and the courts should be wary of relying on market share safe harbors or defining markets broadly to include products that are not effective substitutes because, for example, customers may be unaware of them, face high search costs, or are locked into expensive existing systems.

With respect to aftermarkets in particular, when a manufacturer of a durable good has market power in an aftermarket for parts, service, or other complementary products due to imperfect information, high switching costs, or other factors in the foremarket, ordinary tying and monopolization rules should be employed to prevent the exploitation or extension of such power by anticompetitive means.

III. Intrabrand Vertical Restraints

A. Strengthening the agencies' enforcement posture

The next administration should give more recognition to the importance of intrabrand competition to the economy, particularly with respect to multibrand retailers, and be attentive to the insights of the dual-stage model of product distribution.

If monopolization enforcement was on life support in the Bush II administration, at least at DOJ, enforcement against vertical restraints suffered *rigor mortis*. Neither DOJ nor the FTC brought a vertical agreement case of any variety (even under a monopolization theory), and both agencies urged the Supreme Court in *Leegin* to reverse the venerable *Dr. Miles* per se rule banning minimum resale price maintenance (RPM) agreements.[125] The Supreme Court, of course, followed the agencies' guidance and adopted the rule of reason for RPM, albeit with indications that the rule should not be applied as

[124] Kodak had a market share in the equipment market of only 20 – 23%, but even though such a share would not ordinarily give rise to market power, the Court held that market imperfections could give it market power in the aftermarket for parts and service and that such imperfections could provide the basis for defining a single brand relevant market (parts or service on Kodak machines).

[125] *See* Brief for the United States as Amicus Curiae Supporting Petitioner, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007) (No. 06-480).

permissively as the lower courts have applied the *Sylvania* rule of reason to nonprice restraints, i.e. as a rule of virtual per se *legality*.[126] Yet, the FTC, in its first interpretation of *Leegin*, missed the opportunity to fashion a consumer-friendly structured rule of reason and, with no evidence of consumer benefit, vacated a consent decree prohibiting RPM by a leading maker of women's footwear.[127]

In contrast, in the Clinton administration, the agencies brought at least 16 vertical cases,[128] challenging conduct estimated to have cost consumers hundreds of millions of dollars.[129] As those cases demonstrate, there is no reason to think that vertical distribution agreements are almost always harmless, as the Chicago school has often asserted. On the contrary, even as the Supreme Court was overturning *Dr. Miles*, it cautioned: "the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated."[130] Among other dangers, the Court recognized that RPM induced by powerful dealers was likely to be anticompetitive.[131] And the historical record suggests that RPM agreements often, and nonprice restraints sometimes, have in

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[126] *See, e.g.,* Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 ANTITRUST L.J. 67 (1991).

[127] *See In re* Nine West Group Inc., FTC Dkt. C-3937, Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000 (May 6, 2008) [hereinafter *FTC Nine West Order*]. This decision is discussed further below.

[128] *See* Kovacic, *supra* note 5, at 460. A dozen of these cases were RPM cases. *See* Richard M. Brunell, *Overruling* Dr. Miles: *The Supreme Trade Commission in Action*, 52 ANTITRUST BULL. 475, 479 n.22 (2007).

[129] *See, e.g.,* Press Release, Fed. Trade Comm'n, Record Companies Settle FTC Charges of Restraining Competition in CD Music Market (May 10, 2000), *available at* http://www.ftc.gov/opa/2000/05/cdpres.htm (estimating that music companies' efforts to restrain resale prices of CDs cost consumers as much as $480 million); F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy"*, 1 COMPETITION POLICY INT'L, Autumn 2005, at 65, 68 – 69 (noting that Toys "R" Us estimated that its boycott would increase its margin by $55 million per year). Many of these cases were brought in conjunction with, or led to, cases brought by States and the private bar that resulted in substantial recoveries for consumers. *See* Pamela Jones Harbour, Vertical Restraints: Federal and State Enforcement of Vertical Issues 24 – 27 (March 2005), *available at* http://www.ftc.gov/speeches/harbour/050329vertical.pdf (cataloging recoveries, which significantly exceeded $100 million, including more than $30 million in *Nine West*).

[130] *Leegin*, 127 S. Ct. at 2717.

[131] The Court noted, "If there is evidence retailers were the impetus for a vertical price restraint, there is a greater likelihood that the restraint facilitates a retailer cartel or supports a dominant, inefficient retailer." *Id.* at 2719 (citing Brief for William S. Comanor & Frederic M. Scherer as Amici Curiae Supporting Neither Party at 8, which states, "there are no arguments in economic analysis supporting restraints arising from distributor actions or pressures. In such circumstances, RPM and similar restraints lead to higher consumer prices with no demonstrated redeeming values").

fact been adopted at the behest of high-cost incumbent retailers to raise prices to consumers and retard innovation in retailing.[132] The increase in retail concentration[133] and concomitant rise in buyer power in recent years suggests that vertical intrabrand enforcement should be *more*, not less, vigilant.[134]

The enforcement agencies should give more recognition to the importance of intrabrand competition to the economy and the insights of the dual-stage model of product distribution. Conventional economic analysis tends to adopt a single-stage framework, which ignores the retail function or assumes an inert and perfectly competitive retail sector.[135] However, the retail sector is a significant component of the economy – it keeps about 33 cents of every consumer dollar spent.[136] And intrabrand competition is critically important to promoting competition in retailing, more so than interbrand competition.[137] Indeed, contrary to the common wisdom that "when interbrand competition exists . . . it provides a significant check on the exploitation of intrabrand

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[132] *See* Brunell, *supra* note 128, at 511 n.160 (citing sources); Scherer, *supra* note 129, at 65 (reviewing numerous studies showing instances of harmful vertical restraints).

[133] *See, e.g.,* Kris Hudson, *States Target Big-Box Stores—Maine is First to Require that Wal-Mart, Rivals Undergo Impact Studies,* WALL ST. J., June 29, 2007, at A8 (reporting that in 2006, the ten largest U.S. retailers accounted for 25% of the nation's retail purchases, excluding cars, up from 18% in 1996); Deloitte, *2007 Global Powers of Retailing*, STORES, Jan. 2007, at 2-G8, *available at* http://www.nxtbook.com/nxtbooks/nrfe/stores-globalretail07/index.php (combined sales of ten largest retailers worldwide has grown to nearly 30% of total retail sales of top 250 retailers); ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, BUYING POWER OF MULTIPRODUCT RETAILERS 7 (1999), http://www.oecd.org/dataoecd/1/18/2379299.pdf ("last twenty years have seen momentous changes in retail distribution including significant increases in concentration").

[134] As Justice Breyer pointed out, increasing concentration in retailing "may enable (and motivate) more retailers, accounting for a greater percentage of total retail sales volume, to seek resale price maintenance, thereby making it more difficult for price-cutting competitors (perhaps internet retailers) to obtain market share." *Leegin*, 127 S. Ct. at 2733 (Breyer, J., dissenting).

[135] *See* Robert L. Steiner, *How Manufacturers Deal With the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 ANTITRUST L. J. 407, 408 (1997) (articulating dual-stage theory and criticizing single-stage framework for ignoring reality).

[136] *See* Michael P. Lynch, *Why Economists are Wrong to Neglect Retailing and How Steiner's Theory Provides an Explanation of Important Regularities*, 49 ANTITRUST BULL. 911, 913 (2004). The "retail gross margin" is as a high as 40 – 50% in certain industries, such as apparel and shoe stores. *See id.*

[137] *See* Steiner, *supra* note 135, at 413 (1997) ("[V]igorous intrabrand competition acts directly to depress retail markups on well-known brands and then indirectly to reduce dealer prices on the competing brands it stocks, e.g., by activating interbrand competition within the store.").

market power,"[138] the dual-stage model teaches that manufacturer and retailer margins typically are inversely related so that strong interbrand competition is typically associated with *high* retail gross margins, and that intrabrand competition is the chief force that disciplines retailers' margins.[139]

B. Resale Price Maintenance (RPM)

Some version of the per se rule against resale price maintenance agreements should be restored.

The next administration should support legislation, such as the bill introduced by Senator Kohl,[140] to reverse the Supreme Court's decision in *Leegin* and restore some version of the per se rule for minimum RPM.[141] The Supreme Court's decision to overturn *Dr. Miles* was wrong as a matter of jurisprudence because it flouted the intent of Congress to outlaw RPM, as expressed in the Consumer Goods Pricing Act of 1975.[142] And it was wrong as a matter of policy because there is no reason to think that the costs of false positives under the per se rule exceed the costs of false negatives, adjudication costs, and uncertainty likely to be incurred under the rule of reason. In particular, as the American Antitrust Institute explained in its testimony before the Senate Judiciary Committee,

- The Court underplayed the magnitude of the anticompetitive risks of RPM, including higher prices and reduced efficiency and innovation in retailing, and failed to recognize that those risks have increased with increasing retail concentration.

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138 Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 52 n.19 (1977).

139 *See* Steiner, *supra* note 135, at 413. As Steiner points out, "The freedom of a monopolist retailer to take a monopoly markup in a product category is not constrained because the store stocks numerous competing manufacturers' brands." *Id.*

140 *See* Discount Pricing Consumer Protection Act, S. 2261, 110th Cong. (2007).

141 *See The Leegin Decision: The End of the Consumer Discounts or Good Antitrust Policy?: Hearing Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the S. Comm. on the Judiciary,* 110th Cong. (2007) (written testimony of Richard M. Brunell, Director of Legal Advocacy, American Antitrust Institute), *available at* http://www.antitrustinstitute.org/Archives/leeg07.ashx.

142 *See* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705, 2731 – 32 (2007) (Breyer, J., dissenting); Brunell, *supra* note 128, at 487 – 94.

- The Court overplayed the possible procompetitive uses of RPM and failed to acknowledge that there is no empirical evidence that such uses are common or important.

- The Court failed to consider that any procompetitive effects of RPM can be achieved by less restrictive alternatives that do not prevent efficient retailers from passing on their lower costs to consumers.

- The Court erroneously believed that there were no good justifications for treating RPM and nonprice vertical restraints differently.

- The Court failed to recognize the costs of the rule of reason, including an increased incidence of anticompetitive RPM, increased business uncertainty and litigation expenses, and the loss of uniform treatment among the States.

The agencies should develop a structured rule of reason for RPM under *Leegin*. Until legislation to overturn or modify *Leegin* is enacted, the agencies should take up the Court's invitation to develop a litigation structure for courts to use in applying *Leegin*,[143] as the FTC began to do in its *Nine West* order. In developing a structured rule of reason, which could be set forth in joint guidelines or a joint policy statement, the agencies should conduct hearings or hold workshops to obtain public input, and should collect as many examples as possible of actual procompetitive and anticompetitive uses of RPM (and "soft" RPM, such as *Colgate* policies). In any event, a structured rule of reason should have the following elements:

- RPM should be treated as "inherently suspect" in most circumstances under the framework suggested by *Polygram Holding*,[144] which would make it presumptively unlawful.

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[143] The Supreme Court in *Leegin* invited the lower courts to "establish the litigation structure to ensure the rule [of reason] operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses. Courts can, for example, devise rules over time for offering proof, or even presumptions where justified, to make the rule of reason a fair and efficient way to prohibit anticompetitive restraints and to promote procompetitive ones." *Leegin*, 127 S. Ct. at 2720.

[144] Polygram Holding, Inc. v. FTC, 416 F.3d 29 (D.C. Cir. 2005).

- A manufacturer may rebut the presumption of illegality by coming forward with evidence sufficient to establish that RPM was adopted to achieve a legitimate business purpose that benefits consumers, and that RPM is reasonably necessary to serve that purpose. The agencies' guidelines would delimit the range of permissible justifications, which should not only be theoretically sound, but also likely to be relevant to actual business practices.

- A manufacturer could also rebut the presumption of illegality by showing that the RPM agreement is not likely to harm consumers because its effect on consumers is de minimis (for example, where its market share is slight and its brand is weak).

- If the manufacturer meets its initial burden of production, the burden would shift to the plaintiff to rebut the defendant's purported justification (for example, by showing that RPM was adopted in response to pressure from a powerful retailer or retailers or as a result of dual distribution) or to establish that notwithstanding the justification, RPM is nonetheless anticompetitive (for example, that RPM is widespread and thus facilitates oligopoly pricing or significantly restricts consumer choice).

In its *Nine West* order, the FTC considered the possibility of generally treating RPM as "inherently suspect" under the *Polygram* framework, but ultimately concluded that the "Court's elaboration of . . . relevant factors [making RPM be anticompetitive] provides an approach for identifying when RPM might be subjected to closer analytical scrutiny, such as that anticipated by *Polygram Holdings* [sic] or other truncated rule of reason analyses."[145] In other words, the FTC suggested that an RPM program must run afoul of one of the "*Leegin* factors" before the burden is shifted to the defendant to justify the program as procompetitive. The FTC declined to treat RPM as inherently suspect as a general matter apparently because, even though RPM is designed to raise prices, the Supreme Court "explicitly noted that evidence of price effects would only be the beginning point for further analysis of competitive harm."[146] However, the fact that the Court rejected

[145] *FTC Nine West Order*, *supra* note 127, at 14.

[146] *Id.* at 13; *see Leegin*, 127 S. Ct. at 2718 ("Respondent is mistaken in relying on pricing effects absent a further showing of anticompetitive conduct.").

the price-elevating effect of RPM as an argument for retaining the per se rule – because higher prices may sometimes be accompanied by additional services that consumers value[147] – does not mean it is inappropriate in most cases to place the initial burden on the manufacturer to demonstrate a procompetitive rationale for barring discounting on the products it sells. In the absence of other evidence, eliminating discounting may often be presumed to harm consumers, and the manufacturer is in the best position to provide evidence of procompetitive effects, if it exists. Moreover, RPM has an anticompetitive tendency regardless of the purpose for which it is employed, namely that it generally prevents more efficient retailers from passing on the benefits of their lower costs to consumers.

The FTC's order in *Nine West* is also problematic because of its crabbed analysis of the *Leegin* factors. The Court identified three factors relevant to the rule of reason analysis – number of manufacturers using the restraint, source of the restraint, and market power – and the FTC found that two of these factors (source of the restraint and market power) suggested that Nine West's use of RPM was not likely to harm consumers.[148] The FTC stated that "it appears that Nine West has only a *modest* market share in any putative relevant product market in which it competes,"[149] without indicating what that share is, yet a firm may have sufficient market power to adversely affect consumers even with a "modest" market share if it has a strong brand.[150] Also, the FTC concluded that "Nine West itself is responsible for its desire to engage in resale price maintenance . . . based on

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[147] *See Leegin*, 127 S. Ct. at 2718 (higher prices "'do not necessarily tell us anything *conclusive* about the welfare effects of [resale price maintenance] because the results are generally consistent with both procompetitive and anticompetitive theories'") (quoting THOMAS R. OVERSTREET, JR., RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE 160 (FTC Bureau of Econ. Staff Report 1984)) (emphasis added; alteration in original).

[148] *See FTC Nine West Order*, *supra* note 127, at 15.

[149] *Id.* (emphasis added).

[150] *See generally* LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK § 7.3a1, at 384 – 88 (2006). Indeed, it is commonly understood by economists that neither retailers nor manufacturers will engage in RPM without some interbrand market power. *See, e.g.,* Ward S. Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 849 (1955) ("Price maintenance appears to be incompatible with an assumption of pure competition among both sellers and resellers."); 8 AREEDA & HOVENKAMP, *supra* note 3, ¶ 1632e2, at 324 – 25 ("most products subject to RPM are sufficiently differentiated to enjoy greater pricing discretion than is possible for perfectly competitive products"). Accordingly, the presence of RPM may itself be some evidence of market power.

its wish to increase the services offered by retailers,"[151] yet the FTC found that Nine West's purported procompetitive rationale was "unproven."[152] Moreover, the FTC completely ignored the issue of whether RPM was widespread in the industry, even though Nine West had maintained that one reason it wished to use RPM was that many of its competitors were doing so.[153] And the FTC ignored another plausible anticompetitive explanation for Nine West's RPM program – Nine West is a significant retailer as well as wholesaler.[154] In short, the next administration should take a tougher line on RPM than set forth in the FTC's *Nine West* order.

Coerced RPM under *Colgate* should not be immune from antitrust scrutiny.

If RPM is to be subject to a rule of reason of any sort, then agencies should support repeal or reform of the *Colgate* doctrine legislatively or judicially insofar as that doctrine treats RPM coerced by a manufacturer's threatened refusal to deal as unilateral conduct. It is a legal fiction that there is no agreement when a retailer acquiesces to a manufacturer's demand that the retailer comply with the manufacturer's resale prices or face termination. This fiction has been widely criticized as distorting the concept of agreement under Section 1 and immunizing all manner of vertical restraints without any analysis of actual competitive effects. Insofar as the expansion of the *Colgate* doctrine was driven by the harshness of the *Dr. Miles* rule, it is no longer necessary and should be repealed.[155]

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[151] FTC *Nine West Order*, *supra* note 127, at 15.

[152] *Id.* at 17.

[153] Importantly, the extent of market coverage of RPM should be considered on a local level and should include vertically integrated firms and "informal" RPM. *See* 8 AREEDA & HOVENKAMP, *supra* note 3, ¶ 1606g6, at 96. Moreover, in a concentrated market, coverage need not be extensive to trigger concern about manufacturer coordination. *See id.* ¶ 1606g5, at 96; Brief for William S. Comanor & Frederic M. Scherer Supporting Neither Party at 10, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007) (No. 06-480) (suggesting presumption of illegality in concentrated markets where RPM is implemented by seller with at least 10% market share; "[f]ocusing on oligopolistic sellers' market structure is appropriate because under oligopoly, imitation of one leading seller's marketing strategy by other sellers is more likely").

[154] *See* Letter from the American Antitrust Institute to Deborah Platt Majoras, Re: Petition of Nine West Footwear Corp. to Reopen and Modify Order, FTC File No. 981-0386 (Dec. 5, 2007), *available at* http://www.antitrustinstitute.org/Archives/9W.ashx.

[155] *See* ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY 363 (2003) (suggesting that "*Colgate*'s fiction of 'no agreement' . . . might well be abandoned if *Dr. Miles* is ever overruled").

C. Nonprice distribution restraints

Guidelines for nonprice vertical restraints should also be considered.

The current law on nonprice vertical distribution restraints appropriately treats such restraints as presumptively lawful. "Distribution narrowing" restraints (e.g., territorial or customer restraints or exclusive dealerships) that typically involve single-brand dealers are rarely problematic.[156] However, with the exception of a case like *Toys "R" Us*, the rule of reason has effectively become a rule of per se legality. In connection with adopting guidelines or a policy statement on RPM, the agencies should consider setting forth a structured rule of reason for nonprice intrabrand restraints as well. Consistent with *Sylvania*, such an approach should allow a plaintiff to establish a prima facie case by showing that a manufacturer adopted a significant restriction on intrabrand competition at the behest of one or more powerful retailers, or that the relevant upstream market is concentrated and the restraint has the potential to facilitate upstream collusion.[157]

The agencies should renew enforcement against nonprice vertical restraints.

With respect to enforcement, the agencies should renew efforts to bring challenges to vertical nonprice distribution restraints where powerful incumbent distributors seek to restrict distribution to innovative retailers, as in *Toys "R" Us*.[158]

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[156] *See generally* Warren S. Grimes, *The Path Forward After* Leegin*: Seeking Consensus Reform of the Antitrust Law of Vertical Restraints*, 75 ANTITRUST L.J. (forthcoming 2008). This is largely because single-brand dealers individually rarely have significant market power over manufacturers and are generally tightly integrated with them. In contrast, RPM is typically applied to multibrand retailers in "open distribution" systems. *See id.*

[157] Nonprice restraints may facilitate manufacturer coordination when, for example, multiple manufacturers use the same exclusive distributor in a market, manufacturers restrict dealers' ability to serve markets that are served by other manufacturers, or they use the limitation on the number of outlets to more easily monitor cartel cheating.

[158] Although *Toys "R" Us* involved a horizontal group boycott orchestrated by a powerful retailer, the FTC also found, and the Seventh Circuit affirmed, that the series of vertical agreements between Toys "R" Us and various toy manufacturers independently violated the rule of reason. *See* Toys "R" Us, Inc. v. FTC, 221 F.3d 928, 930 (7th Cir. 2000).