DEPARTMENT OF JUSTICE

Section 2 in the Second Bush Administration

Remarks by

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I. Introduction

Good morning, and welcome to the Sherman Act Section 2 Committee Program, "Hot Topics in Monopolization Law and Policy." I have the privilege of moderating today's discussion among an experienced panel of presenters. I will start by introducing our presenters, and then kick this off with a few words about Section 2[1] enforcement at the Antitrust Division.

Today we'll cover a range of hot topics in monopolization law and policy:

- Our first presenter is Aryeh Friedman, who is the Program Chair for the committee. Aryeh will talk about the impact of *Trinko*[2] on price squeeze claims, in which an integrated firm is alleged to sell key inputs to its competitors at high prices, and to downstream consumers at low prices, such that competitors are effectively "squeezed" out of the downstream market.
- Paul Hewitt, of Akin Gump in Washington, will then talk about another marketing practice, category management, which entails the efforts of a supplier to help a retailer plan and manage in-store promotions for both the supplier's own product and for others' products. One particularly provocative question Paul will address is the extent to which mere "suggestions" made by the category captain may be exclusionary under Section 2.
- Ken Glazer, Senior Competition Counsel at The Coca-Cola Company, will expand our horizons and compare the antitrust treatment of dominant firms in the United States and European Union. His presentation will focus on a number of cases challenging "vertical" conduct by dominant firms, cases involving

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1 15 U.S.C. § 2.

2 *Global Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

allegations of an abuse of dominance or monopoly power with respect to customers or suppliers.

- Lastly, Mary Anne Mason, of Hogan & Hartson, will continue the discussion of the EU's approach to dominance with an illuminating presentation on the European Commission's case against Microsoft.

That is our lineup for today's program. We will save time for your questions after all presenters have spoken. Before I turn it over to Aryeh, I will say a few words about the DOJ's approach to Section 2 and the recent *Dentsply*[3] decision, and make some observations about the future of DOJ Section 2 enforcement.

II. The Antitrust Division's Top Enforcement Priorities

During the past four years the Antitrust Division has established for itself and promoted internationally an enforcement hierarchy that calls for aggressive action against clearly harmful conduct (criminal cartel activity) and takes a balanced, cautious approach towards conduct about which one may not be so confident (such as unilateral conduct by dominant firms).

In this hierarchy, the Division's highest priority is Section 1[4] criminal prosecution of cartels. We have said it before, and we will say it again. Secret agreements among competitors to fix prices, allocate customers, or reduce output are unambiguously anticompetitive and a direct assault on the principles of competition that drive our market economy. These conspirators are committing frauds against their customers and deserve severe penalties.

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[3] *United States v. Dentsply International, Inc.*, 277 F. Supp. 2d 387 (D. Del 2003), rev'd and remanded by, 399 F.3d 181 (3d Cir. 2005).

[4] 15 U.S.C. § 1.

Next in the hierarchy is mergers, reviewed under Section 7.[5] Mergers that substantially lessen competition may lead to fewer choices, less innovation, and increased prices. Other mergers are benign or affirmatively procompetitive. Therefore, merger review calls for caution, especially because we typically review mergers before consummation, requiring a prediction of future effects, inherently more difficult than assessing past harm.

Next is conduct that violates the Sherman Act but would not be prosecuted criminally. We exercise caution in this area, to minimize the possibility of unintended harm from unwarranted challenges where the competitive effect of the conduct may be ambiguous. Joint ventures and other agreements among market participants that are covered by Section 1 may, like mergers, be procompetitive or anticompetitive; if found anticompetitive after a rule of reason balancing, the Division will challenge such agreements in civil litigation. We are most cautious with monopolization and other unilateral conduct that may violate Section 2, because with unilateral conduct it is most difficult to distinguish between harmful exclusionary conduct and beneficial hard-nosed competition, and here overzealous antitrust enforcement itself can harm consumer welfare.

III. DOJ's Approach to Section 2

With that enforcement hierarchy established, I will make three quick points about our approach to Section 2 cases.

First, monopolization is bad. It leads to higher prices, lower output, less innovation, and enhanced incentives to exclude rivals. When uncovered, exclusionary conduct that creates or maintains monopoly should be vigorously challenged.

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5 15 U.S.C. § 18

Second, recognizing the difficulty of confidently identifying exclusionary conduct and the risks of unwarranted enforcement, the Division favors objective, transparent standards based on sound economics. The favorite modern example is the standard that the government advocated in *Trinko,*[6] under which conduct would not be found exclusionary unless it made no economic sense but for its tendency to reduce or eliminate competition.

Third, ranking Section 2 enforcement behind cartels and mergers does not mean Section 2 enforcement is not important. It reflects the difficulty of distinguishing anticompetitive from procompetitive behavior when evaluating unilateral conduct and the uncertainty of predicting the long-term effects of unilateral conduct on consumers in particular cases. The detection and analysis of exclusionary single firm conduct is not well developed; that compels caution. The *amicus* brief the United States filed at the Supreme Court in *LePage's* reflected this approach in explaining that "although the business community and consumers would benefit from clear, objective guidance on the application of Section 2 to bundled rebates, [the *LePage's*] case does not present an attractive vehicle for [the] Court to attempt to provide such guidance."[7] Rather, we believed that it was "preferable to allow the case law and economic analysis to develop further and to await a case with a record better adapted to development of an appropriate standard." *Id.*

III. A Recent Development: *United States v. Dentsply*

Turning to *United States v. Dentsply*. Courtesy of the Third Circuit Court of Appeals, *Dentsply* has been made available for Section 2 hot topic discussion.

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[6] Brief for the United States and the Federal Trade Commission as Amici Curiae, *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (No. 02-682), *available at* http://www.usdoj.gov/atr/cases/f200500/200558.htm.

[7] Brief of United States as Amicus Curiae at 19, *3M Company v. LePage's Inc.*, 124 S.Ct. 2932 (2004) (No. 02-1865), *available at* http://www.usdoj.gov/atr/cases/f203900/203900.pdf.

Briefly, some background. Dentsply manufactures artificial teeth. It is the dominant U.S. manufacturer, with a sustained market share of 75-80 percent, about 15 times the size of its next closest competitor. Dentsply sells its teeth in the United States through a network of dealers, which provide teeth and other dental products to dental labs. The labs use the teeth to make dentures and other dental appliances. Dentsply has an exclusivity policy; it will not sell to dealers that carry competitors' teeth. Not surprisingly, Dentsply's competitors mainly sell directly to the dental labs, not through the dealer network.

The United States sued Dentsply in the District of Delaware in 1999, alleging (a) that the company possessed monopoly power in the market for the sale of prefabricated artificial teeth in the United States and (b) that Dentsply's policy of refusing to sell to dealers that carried rivals' teeth deprived those rivals of access to the market and thereby unlawfully maintained Dentsply's monopoly. The complaint charged violations of Sherman Act §§ 1 and 2 and Clayton Act § 3.[8] Because we appealed only on Section 2, I will not discuss the other claims.

After a bench trial, the district court issued a lengthy opinion. A number of the court's findings seemed to decisively favor the government:

(1) Dentsply had had a persistently high market share, and that predominant share of the relevant market was more than adequate to establish a prima facie case that the company had monopoly power.

(2) Dentsply was a "price leader" know for its "aggressive price increases in the market."[9]

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8 Complaint, *United States v. Dentsply International, Inc*, 399 F.3d 181 (3d Cir. 2005) (No. 03-4097), *available at* http://www.usdoj.gov/atr/cases/indx102.htm; 15 U.S.C. § 14.

9 *Dentsply International, Inc.*, 277 F. Supp. 2d at 422.

(3) Dentsply adopted and enforced the exclusivity policy with the “express,” “sole,” and “anti-competitive” rationale of excluding competitors.[10]

(4) If the exclusivity policy were abolished, prices would fall.

(5) Dentsply’s procompetitive justifications for its exclusive policy were “pretextual.”[11]

The district court ruled for Dentsply on all claims.

What happened?

The judge concluded that direct sales to dental labs was a *viable* method of distribution and therefore that Dentsply did not have monopoly power and its exclusivity policy had not effectively foreclosed competition so that it could maintain a monopoly.

Reading the district court opinion, it appeared to us that, if the exclusivity policy *were* ineffective, then this was a market governed by irrationality, as highlighted by an obviously unnecessary and pointless 15-year campaign to exclude rivals.

The United States appealed the adverse ruling on monopoly maintenance, arguing that the district court failed to impose liability under Section 2 because it applied the wrong legal standard. Citing the 2001 *Microsoft*[12] decision, the government argued that the question is not whether alternative channels are “available” and “viable,” or whether rivals can survive by using them, but rather whether such channels “pose a real threat” to Dentsply’s exercise of monopoly power.[13]

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10 *Id.* at 440.

11 *Id.*

12 *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001).

13 Brief for the United States at 32-33, *United States v. Dentsply International*, *Inc.*, 399 F.3d 181 (3d Cir. 2005) (No. 03-4097), *available at*http://www.usdoj.gov/atr/cases/indx102.htm.

The Third Circuit heard oral argument in September 2004, and in February unanimously reversed the district court.

I will outline how the district and appeals courts addressed the two monopolization elements – monopoly power and maintenance of the monopoly through exclusionary conduct – and then suggest why the *Dentsply* opinion may be significant.

Monopoly power. First, monopoly power. The district court observed that monopoly power could be inferred from a market share like Dentsply's, but not where there is evidence that the defendant cannot control prices or exclude competitors. The district court concluded that Dentsply could not exclude, despite its exclusivity policy, because "direct selling to the laboratories is a viable . . . method of distribution."[14]

The court of appeals agreed that Dentsply's market share was sufficient to establish monopoly power. It went a step further, citing as additional proof of the company's monopoly power evidence of Dentsply's pricing practices, including its reputation for aggressive price increases and its failure to reduce its prices when competitors elected not to follow.

The court of appeals disagreed with the district judge's findings on direct distribution, which it thought clear error. The appeals court laid out the "market realities" that showed why the evidence did not undercut the inference that Dentsply *did* have monopoly power. The facts showed that over the years direct sales had proven not to be a practical alternative and that Dentsply's competitors could not convince dealers to carry them because that required dropping the Dentsply line altogether. The court of appeals further observed that "the firm that ties up the key dealers rules the market," and concluded from the evidence that Dentsply's monopoly position was due to its "supremacy over the dealer network."[15]

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[14] *Dentsply International, Inc.*, 277 F. Supp.2d at 452.
[15] *Dentsply International, Inc.*, 399 F.3d at 190.

Anticompetitive effects. The second element is willful maintenance. The district court concluded that competing tooth manufacturers could survive despite Dentsply's exclusivity policy, which could not keep competitors from gaining a foothold to challenge Dentsply's position.

The court of appeals adopted, as the government had urged, the *Microsoft* case standard for determining whether conduct illegally foreclosed competition: "The proper inquiry is not whether direct sales enable a competitor to 'survive' but rather whether direct selling 'poses a real threat' to defendant's monopoly."[16] Applying this standard, the appeals court concluded that the small market shares of Dentsply's competitors, which sold directly to dental labs, revealed that selling directly actually posed little threat to Dentsply's dominant position. The district court finding that direct sales are "viable" was clearly erroneous if the court meant "practical or feasible" in this market, as opposed to just "possible." Further disagreeing with the district court on the facts, the appeals court recognized that labs actually preferred to buy through dealers and therefore that it was *not* feasible for competing manufacturers to make significant sales directly to labs. The exclusivity requirement Dentsply imposed on dealers "created a strong economic incentive for dealers to reject competing lines in favor of Dentsply's teeth."[17]

In addition, Dentsply had urged the court of appeals to follow a line of exclusive dealing cases that had focused on the extent to which a defendant has contractually foreclosed distribution options. The court agreed with the district court's characterization of the "at-will" nature of Dentsply's relationship with dealers, but it disagreed with the district court's conclusion that rivals could therefore "steal" dealers from Dentsply at any time simply by offering a better deal. Instead, the court determined that, given market realities, no dealer could

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[16] *Id.* at 193.
[17] *Id.* at 195.

afford to forsake all of its Dentsply business in order to sell teeth of tiny rivals. The court concluded that "[b]y ensuring that the key dealers offer Dentsply teeth either as the only or dominant choice, [Dentsply's policy] has a significant effect in preserving Dentsply's monopoly. . . . [and] is a solid pillar of harm to competition."[18]

Finally, the court of appeals held that the district court erred when it relied on dicta in *Tampa Electric Co. v. Nashville Coal Co.*[19] to hold that there could be no violation of Section 2 where it had found no liability under the standards of Clayton Act § 3.[20] The court relied on its statement in *LePage's* that a finding of no liability under Section 3 did not preclude the application of evidence of exclusive dealing to support a claim under Section 2.[21]

The court of appeals remanded the case to the district court with instructions to enter an injunction against Dentsply. Notably, this is the first case since the Seventh Circuit's 1979 decision in *United States v. Household Finance*,[22] in which the Antitrust Division has obtained an outright reversal of an adverse decision following a full trial on the merits.

Let me offer a few brief observations about the *Dentsply* decision and what it may mean for Section 2 enforcement going forward.

First, it is a good sign that the Third Circuit paid such close attention to the facts and focused on the "market realities" of Dentsply's exclusionary policy. For example, Dentsply argued that exclusive dealing cannot have anticompetitive effects if there is *some* available distribution channel through which rivals could potentially reach end users. It argued: if there exist alternative channels, then there is "*no* foreclosure." The Third Circuit rejected that

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18 *Id.* at 191.
19 *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961)
20 *Dentsply International, Inc.*, 399 F.3d at 197.
21 *Id.*
22 *United States v. Household Finance Corp.*, 602 F.2d 1255 (7th Cir. 1979).

argument and said that the existence of competitive effects depends on the *effectiveness* of the alternative distribution channels. As Section 2 law develops towards standards that demand more certainty, it will be important for courts to focus on the realities of particular markets and not decide cases based purely on inferences from market structure alone. A more heightened awareness of market realities will, one hopes, help prevent false positives that erroneously condemn procompetitive conduct and thus threaten to chill the kind of aggressive competition the antitrust laws should encourage.

Second, these facts presented a good opportunity to apply the *Microsoft* standard for identifying at what point anticompetitive conduct that may be only one factor in monopoly maintenance should be counted as illegal: one needs proof that a "defendant has engaged in anticompetitive conduct that reasonably appear[s]... [to be a] significant contribution to... maintaining monopoly power."[23] This is important because Dentsply had argued that this legal standard was wrong and that as a matter of law a monopolist may freely practice exclusive dealing so long as alternative channels allow rivals to reach end-users. The Third Circuit correctly rejected that argument and followed *Microsoft* in concluding that the proper inquiry is whether those alternative channels allow rivals to "pose a real threat" to the defendant's monopoly.[24]

Third, the Third Circuit declined to follow the exclusive dealing cases that focused on duration of contractual foreclosure of distribution. Even though Dentsply did not have fixed or long-term contracts with its dealers, the court recognized that the dealers could still be effectively tied up by Dentsply's exclusivity requirement. Again, the court looked to market realities and recognized that none of the dealers were going to turn away the supplier of 80

[23] *Microsoft*, 253 F.3d at 79.
[24] *Dentsply International, Inc.*, 399 F.3d at 193.

percent of the market in order to be able to carry the teeth of a manufacturer with 3 percent of the market. Tellingly, the court emphasized this point in the very first paragraph of the opinion, where it specifically noted that it had reached its conclusion "despite the lack of long term contracts between [Dentsply] and its dealers."[25]

Finally, I should add that the court of appeals did not really have to address the "no economic sense" standard that we advocated in *Trinko*. That is because, as I mentioned earlier, the district court found that "Dentsply's express purpose in enacting and enforcing [its exclusionary policy] was anti-competitive"[26] and that Dentsply's business justification for its policy was pretextual.

Congratulations to the staff of the Division's Litigation 1 Section, Appellate Section, and Adam Hirsh, who argued the appeal. But since Dentsply may still seek en banc review or petition for certiorari, stay tuned.[27]

IV. The Future of Section 2 Enforcement

What is in Section 2's future at DOJ?

You can expect DOJ will continue to advocate objective, transparent standards based on sound economics, including the "no economic sense" standard. DOJ remains committed to investigating and vigorously prosecuting Section 2 violations when conduct is found that violates this standard. Finally, DOJ will also continue to work to clarify the Section 2 standard as applied in particular situations, not only in enforcement actions, but also through amicus filings and public statements.

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25 *Id.* at 184.

26 *Dentsply International, Inc.*, 277 F. Supp. 2d at 440.

27 En Banc review was denied on May 17, 2005.

You can expect DOJ to be engaged in the debate before the Antitrust Modernization Commission on ways to improve the antitrust laws in general and Section 2 in particular. In early January, Assistant Attorney General Hew Pate wrote to the Commission suggesting possible topics for study.[28] Making changes to the basic language of Sherman Act itself was not among them. The letter suggested that changes to the Sherman Act "should be undertaken only with great caution, as it is almost certain that more harm than good would come from a change."

Hew Pate suggested that the Commission study whether consumers would be better off in a system that excluded treble-damage availability in non-cartel Sherman Act cases. He noted that

> Sherman Act section 2 cases are highly dependent on specific facts and economic analysis. Courts and legal commentators have struggled to articulate clear differences between legal and illegal conduct. A company may not even know it has violated section 2 until well after the fact. In such circumstances, given the fear of potential future treble damage exposure, companies may be reluctant to engage in conduct that would be procompetitive and beneficial to consumers.[29]

At its January 13, 2005 meeting, the Commission selected an initial slate of issues for study, including what should be the remedies and legal liabilities in private antitrust proceedings and whether substantive standards for determining whether conduct is exclusionary under Section 1 or Section 2 should be revisited.

V. Conclusion

This is a hot year for Section 2. Let me turn to our next presenter, Aryeh Friedman. Thank you.

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[28] Letter from R. Hewitt Pate, Assistant Attorney General, Antitrust Division of the Department of Justice, to Deborah A. Garza, Chair, Antitrust Modernization Commission (Jan. 5, 2005), *available at* http://www.usdoj.gov/atr/public/comments/207122.pdf.

[29] *Id.* at 2.