



# **DEPARTMENT OF JUSTICE**

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## **Navigating Scylla and Charybdis: Three Stages in the Journey to Effective Section 2 Enforcement**

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## I. Introduction

The United States set out on a great journey – indeed, an epic saga – when it enacted the Sherman Act in 1890. While many aspects of that saga warrant discussion, I will focus my attention today on the evolution of enforcement against unilateral conduct under Section 2. In doing so, I will draw on some parallels that might not have occurred to you between this journey and the fabled saga of Odysseus. While his journey also covered many years and included many adventures, I will focus today on one particular challenge: How to pass through the gauntlet of Scylla and Charybdis on the journey home.

As an initial matter, we need to define our goal. For Odysseus, that goal was returning home. Although he wandered for so many years and took so many detours that one might wonder how committed he was to reaching that goal, he ultimately did reach his home in Ithaca, Greece. For us, while we too wandered for many years, it is now settled that the Sherman Act “rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress.”<sup>1</sup> So, our goal

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<sup>1</sup> N. Pac Ry. Co. v. United States, 356 U.S. 1, 4 (1958).

is to enforce Section 2 in a manner that increases overall efficiency and, thereby, consumer welfare.

To further set the stage for our adventure today, you may recall that Scylla was a six-headed monster that would attack and eat crewmen within its reach. On the other side of the channel, Charybdis was a giant mouth that sucked in huge quantities of water, creating a whirlpool that would pull a ship down to its doom, killing all aboard, and then spit it back out. Odysseus had to pass between these two creatures to reach home. Many place the gauntlet in the exceptionally narrow Strait of Messina, between the island of Sicily and mainland Italy.

In my time today, I will discuss how our enforcement of Section 2 similarly has sought to navigate between two dangers, steering first toward Scylla and then veering toward the whirlpool created by Charybdis. Now, we seek a mid-channel passage that will avoid the dangers lurking on either side.

## II. Scylla: Formalistic Prohibitions Not Based on Competitive Effects

I turn first to the early days of antitrust enforcement against single firm conduct. My colleague, Chairman Kovacic, has succinctly summarized the situation:

Before the change of direction in the past three decades, U.S. doctrine and enforcement policy toward dominant firms generally had been more intervention-minded than the competition policy systems of other jurisdictions before or since. Judicial decisions adopted an expansive view of abuse. For a time in the 1940s, the Supreme Court seemed poised to dispense with the requirement of abusive conduct and endorse a no-fault theory of monopolization. Although Section 2 cases in this period required some element of bad conduct, courts defined the concept of wrongful behavior so broadly that a wide range of conduct sufficed to create liability. Public enforcement policy toward dominant firms in this period also was far-reaching and at times featured ambitious efforts to restructure the affected industries through divestitures or the compulsory licensing of intellectual property.<sup>2</sup>

This approach had problems. The basic problem was not, as some might reflexively suppose, simply that the approach was interventionist. There are other areas of the antitrust laws where we are and should be highly interventionist – cartel enforcement being the prime example. And such rules can be relatively clear and easy to administer. Indeed, a rule of per se liability for having monopoly power could be relatively clear.

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<sup>2</sup> Statement of Chairman William E. Kovacic, Fed. Trade Comm’n, Modern U.S. Competition Law and the Treatment of Dominant Firms: Comments on the Department of Justice and Federal Trade Commission Proceedings Relating to Section 2 of the Sherman Act 3 (Sept. 8, 2008) (footnotes omitted) [hereinafter Kovacic Statement], available at <http://www.ftc.gov/os/2008/09/080908section2stmtkovacic.pdf>.

Rather, the problem with this early approach is that the rules on what a firm could and could not do were not based on reasonable judgments about whether the conduct was likely to harm the competitive process. Instead, many prohibitions emanated from concerns that companies should not be too “big” or that individual competitors (often smaller companies) should be protected for their own sake. The approach caused the government (and private plaintiffs) to attack firms for engaging in behavior that, although perhaps aggressive, nonetheless was a beneficial part of the competitive process. As a result, this approach did not maximize the goal of economic growth and enhanced consumer welfare. We had steered the ship of antitrust too close to Scylla, causing harm to innocent firms and ultimately to ourselves.

### III. Charybdis: Pure Effects-Based Analysis

As Chairman Kovacic also has eloquently explained, we began to steer antitrust away from Scylla several decades ago. A key element of this shift was the recognition that the Sherman Act is a charter for enhancing economic efficiency and, thereby, consumer welfare.<sup>3</sup> Chairman Kovacic recently observed:

The definition of liability standards and the analysis of specific claims of unlawful exclusion overwhelmingly address

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<sup>3</sup> See, e.g., *N. Pac. Ry.*, 356 U.S. 1.

efficiency effects. The relevant decisions do not consider how the defendant's conduct might have affected the attainment of a more egalitarian economic environment or the pursuit of related objectives that animated competition policy at various times from the 1940s to the early 1970s.<sup>4</sup>

Thus, we altered course to pursue conduct that creates anticompetitive effects, defined as harming efficiency. Such an effects-based analysis lends itself to economic analysis, which has properly become the analytical framework for antitrust. This shift, while certainly in the right direction, nevertheless created a risk that we would over-steer into the vortex created by Charybdis. An open-ended effects analysis is highly fact intensive. It can consume large amounts of time and resources, and its outcome is difficult to predict in advance. We risk engulfing the economy in countless burdensome investigations and litigation.

Then-Judge Breyer warned us about the risk of pursuing every conceivable anticompetitive effect:

[U]nlike economics, law is an administrative system the effects of which depend upon the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the

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<sup>4</sup> Kovacic Statement, *supra* note 2, at 3-4. This focus on efficiency is now widely accepted internationally as well as in the U.S. See, e.g., DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, at ¶ 4 (“the objective of Article 82 is the protection of competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources”), available at <http://ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf>.

vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve. . . . [W]e must be concerned lest a rule . . . that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition.<sup>5</sup>

Thus, calls for maintaining the option for a plaintiff to pursue every possible theory of anticompetitive harm – no matter how unlikely or how small the harm – can undermine economic growth and harm consumer welfare. Indeed, there is widespread recognition of the costs and burdens associated with such an open-ended, effects-based analysis. During the recent hearings on Section 2 held by the DOJ and FTC, several panelists and commentators have pointed out that, in practice, courts do not engage in the precise balancing called for by the effects-balancing test. One panelist explained that, “when you look at the decisions, the courts never reach [a] final balancing stage.”<sup>6</sup> Another panelist agreed, stating that no “court has ever written an opinion saying, now that it is all over, we find that there are these harms and these efficiencies and we are now going to weigh them and we are going to choose between the two.”<sup>7</sup>

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<sup>5</sup> *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.).

<sup>6</sup> Sherman Act Section 2 Joint Hearing: Section 2 Policy Issues Hr’g Tr. 60, May 1, 2007 [hereinafter May 1 Hr’g Tr.] (Kolasky).

<sup>7</sup> *Id.* at 103 (Krattenmaker); *see also* Sherman Act Section 2 Joint Hearing: Conduct as Related to Competition Hr’g Tr. 30, May 8, 2007 (Melamed) (“[T]o talk about . . . balancing as a solution to the problem where you have both benefit and harm . . . is nonsense. And I don’t think any court does it.”); *id.* at 32 (Rule) (stating that balancing “becomes infinitely more difficult . . . in a Section 2 context for a variety of reasons”);

This concern is particularly severe in the context of unilateral conduct. Firms make unilateral business decisions on a continuous basis, each one of which is potentially subject to antitrust scrutiny and/or condemnation. They cannot navigate effectively without a chart to guide their way. They cannot halt in mid-passage to perform an open-ended, effects-based analysis that requires more information than they likely possess. Instead, they will steer clear of the entire area – sail around Sicily instead of passing directly through the Strait of Messina – to the detriment of economic growth and consumer welfare.

#### IV. The Mid-Channel Course

Odysseus, you may recall, solved his dilemma by steering toward Scylla and sacrificing six crewmen – one to each head of the monster. He decided that this sacrifice was better than losing the entire ship down the whirlpool of Charybdis. We strive to do better; we strive to find a mid-channel course. We are likely to advance our goal of economic growth and increased consumer welfare most effectively if we avoid both the formalism of rigid prohibitions and the unstructured, open-ended vortex of a pure

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May 1 Hr'g Tr., *supra* note 6, at 81 (Calkins) (“[Y]ou never get to the last step, and so it is not really a balancing . . .”).

effects-based analysis.<sup>8</sup> We should seek liability standards that are based on clear and objective criteria, that effectively identify conduct likely to harm the competitive process, and that take into account institutional limitations and costs of administration.<sup>9</sup>

#### A. Key Principles

Led by a wide range of legal and economic scholars – and by our courts – the United States for the last several decades has been seeking just such a mid-channel course for treating unilateral conduct. We have made progress, as illustrated by the following examples.

First, we reaffirm that the enterprise is worth the effort. The Department of Justice is committed to enforcing Section 2. Indeed, our efforts to develop clear and objective criteria for defining violations will enhance our enforcement in three ways: (i) businesses will be better able to discern where the line is and to avoid committing a violation in the first

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<sup>8</sup> “Although we understand the great difficulty of the task, clarity about the meaning of dominance and exclusionary abuse will promote and nurture a dynamic and innovative European economy.” Joint Comments of the American Bar Association’s Section of Antitrust Law and Section of International Law on the Commission Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses 2 (December 2005), *available at* <http://www.abanet.org/antitrust/at-comments/2006/06-06/com-article-82.pdf>.

<sup>9</sup> “In general, standards for applying Section 2 of the Sherman Act’s broad proscription against anticompetitive conduct should be clear and predictable in application, administrable, and designed to minimize overdeterrence and underdeterrence, both of which impair consumer welfare.” ANTITRUST MODERNIZATION COMM’N, REPORT AND RECOMMENDATIONS 88 (2007), *available at* [http://govinfo.library.unt.edu/amc/report\\_recommendation/amc\\_final\\_report.pdf](http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf).

instance; (ii) when violations occur, they will be easier to detect and prove; and (iii) effective remedies will be easier to craft and obtain.

Second, as discussed above, the focus on efficiency and harm to the competitive process is an important step. While Section 2 advances economic growth by prohibiting certain conduct that leads to monopoly, it also advances economic growth by what it does not prohibit. It does not prohibit mere possession of monopoly power, which can be the consequence of the beneficial competitive process. Further, competition is an inherently dynamic – and sometimes destructive – process. We have learned better to avoid protecting firms from the rough and tumble of competition and to intervene only where the process itself has been undermined.

Third, we give greater consideration to the limits of institutions. Neither agencies nor courts nor private plaintiffs excel at traditional regulatory functions, such as setting rates or other terms of dealing. Thus, we avoid standards of liability and remedies that would require courts to set prices or other terms of dealing. Nor are courts always well equipped to discern the difference between aggressive competition on the merits and harm to the competitive process. Thus, courts seek rules of decision that avoid the costs and burdens of an open-ended effects balancing test. These measures include allocations of burdens of production and proof, such as

those described by the D.C. Circuit in its *Microsoft* decision.<sup>10</sup> They also include safe harbors, such as those based on costs as set forth in *Brooke Group* and *Weyerhaeuser*.<sup>11</sup>

In a similar vein, Odysseus had to recognize the limitations of his ship and crew. He had only oars and sails to power the ship, with no radar, global positioning technology, or satellite photos to forecast weather. As we develop better tools for identifying anticompetitive conduct, we can enhance our options for successfully navigating the gauntlet.

Fourth, we have greater appreciation for the beneficial effects of many kinds of conduct and for the harm that can be imposed by restricting such conduct. In addition to taking into account the costs of investigations and litigation, we better appreciate that low prices, exclusive dealing, tying, and other conduct can create efficiencies and benefit consumers. As observed by the Antitrust Modernization Commission, “business practices typically offer more efficiencies and, thus, benefits to consumer welfare, than recognized in the early-to-mid-twentieth century.”<sup>12</sup>

On a closely related front, we better appreciate the benefits to consumers of providing a reasonably accurate chart to the business

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<sup>10</sup> See *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (en banc) (per curiam).

<sup>11</sup> See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007).

<sup>12</sup> ANTITRUST MODERNIZATION COMM’N, *supra* note 8, at 90.

community. Thus, the Supreme Court rejected a predatory bidding claim that was based on claims that the firm paid more than a “fair price” because of “the risk of chilling procompetitive behavior with too lax a liability standard.”<sup>13</sup> As one former Antitrust Division official as put it: “Transparency helps to ensure that like cases are treated alike. It also, by making the legal rules more clear, reduces uncertainty and risk facing businesses and thereby enhances efficiency.”<sup>14</sup>

Fifth, as we seek to refine our analysis, we adjust our course in different directions at different times. One example can be found in the no economic sense test. Although variations exist, the basic logic of the test is that a unilateral action should be lawful if it makes economic sense to the firm without regard to its exclusionary effect on competitors. The Department and the Federal Trade Commission jointly endorsed the no economic sense test in the context of the refusal-to-deal claim in *Trinko*. In proposing the test, the agencies sought to reduce the need to engage in effects balancing. After studying the issues further, however, the Department recently declined to endorse the no economic sense test as a general test for liability under Section 2.

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<sup>13</sup> *Weyerhaeuser*, 127 S. Ct. 1069, 1071 (2007).

<sup>14</sup> A. Douglas Melamed, Deputy Assistant Attorney Gen., U.S. Dep’t of Justice, Antitrust at the Turn of the Century 8 (December 7, 1999), *available at* <http://www.usdoj.gov/atr/public/speeches/5232.htm>.

The Department suggested instead that consumer welfare is more likely to be enhanced through use of well-crafted, conduct-specific tests with a fallback to the use of the disproportionality test where necessary. The disproportionality test has been endorsed in the *Antitrust Law* treatise.<sup>15</sup> Further, both the Department of Justice and the Federal Trade Commission endorsed the disproportionality test in their amicus brief filed in *Trinko*, stating as follows:

However, [Section 2 analysis] does not entail open-ended “‘balancing’ of social gains against competitive harms,” for “a firm is under no obligation to sacrifice its own profits” for the public weal. Instead, the harm to competition must be disproportionate to consumer benefits (in terms of providing a superior product, for example) and to the economic benefits to the defendant (aside from benefits that accrue from diminished competition).<sup>16</sup>

The Department also recently considered the issue of bundled discounts. Numerous commentators have called for applying a *Brooke Group* test to the entire bundle, which reduces the need to weigh competitive

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<sup>15</sup> 3 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, ¶ 651a, at 72 (2d ed. 2002) (describing exclusionary conduct as acts that, among other things, “produce harms disproportionate to the resulting benefits”).

<sup>16</sup> Brief for the United States & the Federal Trade Commission as Amici Curiae Supporting Petitioner at 14, *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (No. 02-682) (quoting 3 AREEDA & HOVENKAMP, *supra* note 15, ¶¶ 651a, 658f, at 72, 131-132), *available at* <http://www.usdoj.gov/atr/cases/f201000/201048.htm>.

effects in each case.<sup>17</sup> The Department, however, declined to endorse such an approach, instead suggesting two distinct theories of competitive harm – predation and tying – that could support a claim under Section 2.

In another example, the Department examined the role of market shares in Section 2 analysis. On the one hand, “[i]f a firm has maintained a market share in excess of two-thirds for a significant period and the firm's market share is unlikely to be eroded in the near future, the Department believes that such facts ordinarily should establish a rebuttable presumption that the firm possesses monopoly power.”<sup>18</sup> On the other hand, the Department identified a market share screen for monopoly power as worthy of consideration by courts to reduce the need to engage in effects balancing. No court has found the existence of monopoly power in circumstances where the defendant’s sales accounted for less than 50 percent of the relevant market.<sup>19</sup> Under these circumstances, it is plausible that the search for monopoly where the defendant’s market share is less than 50 percent is not worth the costs, even if it is theoretically possible for such a monopoly to exist.

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<sup>17</sup> U.S. DEPARTMENT OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 98-99 (2008).

<sup>18</sup> *Id.* at 31.

<sup>19</sup> *Id.* at 24.

## B. Sources

The progress described above reflects a broad-based consensus across the philosophical spectrum that now has been deeply embedded in judicial precedent. I commend to your attention the observations of Chairman Kovacic in this regard:

The intellectual DNA of U.S. antitrust doctrine governing single-firm conduct today is mainly a double helix that intertwines two chains of ideas, one drawn from the Chicago School of Robert Bork, Richard Posner, and Frank Easterbrook, and the other drawn from the modern Harvard School of Phillip Areeda, Donald Turner, and Steven Breyer. The combination of Chicago School and Harvard School perspectives features shared prescriptions about the appropriate substantive theories for antitrust enforcement (Chicago's main contribution to the double helix) and cautions about the administrability of legal rules and the capacity of the institutions entrusted with implementing them (Harvard's main contribution to the double helix). The double helix of ideas does not preclude enforcement, but it has supported the acceptance of presumptions that elevate the hurdles that antitrust plaintiffs must clear to prevail in the courts.<sup>20</sup>

It is therefore understandable – although it is nonetheless remarkable – that all three Supreme Court decisions addressing Section 2 claims during the last decade were decided without any dissent. These include *Trinko* and *Weyerhaeuser*, which incorporate the principles of clear and objective standards and concerns with administrability that animate the Department's approach to Section 2 enforcement.

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<sup>20</sup> Kovacic Statement, *supra* note 2, at 5 (footnotes omitted).

## V. Conclusion

The journey to find the best way to enforce Section 2 of the Sherman Act is a difficult one, and the best course is subject to legitimate debate. In discussing the issues, it is better to focus on the substance than to seek to impress with rhetorical flourish. We all strive toward the same goal; where we differ, it is only in the means to increase economic growth and enhance consumer welfare.

As we put ideas on the table for discussion, it is useful to challenge assumptions and analysis and thereby to improve both. It is even more helpful, however, if one can set forth constructive ideas for how to address the issues. As Odysseus could confirm, while it can be satisfying to criticize the steering of the ship, the more important task is to provide guidance on how to steer away from the danger on either side. I look forward to continuing the dialogue.