The Justice Department's Section 2 Report:
A Mixed Review

William Kolasky

The United States is virtually alone in having two national competition authorities with overlapping authority to enforce the antitrust laws. Over the nearly one hundred years since the Federal Trade Commission was created in 1914, the FTC and Department of Justice Antitrust Division have co-existed in relative harmony. While the two agencies have often pursued different enforcement agendas, they have rarely been in conflict as to the fundamental direction of antitrust enforcement policy.

This year, however, we now have an open split between the two agencies over the standards that should govern antitrust enforcement policy with respect to single-firm conduct under Section 2 of the Sherman Act. After a series of joint workshops with the FTC on monopolization, the Justice Department in September released its own separate report entitled *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*.[1] In that Report, the Justice Department argues in favor of a relatively narrow role for the antitrust laws in policing the conduct of dominant and near-dominant firms. The Report proposes what it calls a "substantial disproportionality" test, under which the Department says it will not bring a Section 2 enforcement action unless a firm with monopoly or near-monopoly power engages in conduct, the anticompetitive effects of which are "substantially disproportionate" to its procompetitive justifications.

The same day, the FTC released a stinging statement signed by three of the four sitting Commissioners, attacking the Justice Department Report as "a blueprint for radically weakened enforcement of Section 2 of the Sherman Act."[2] In equally colorful language, the FTC statement claimed that the Report "would place a thumb on the scales in favor of firms with monopoly or near-monopoly power" and against the interests of consumers. The statement concluded by saying that the FTC "stands ready to fill any Sherman Act enforcement void that might be created if the Department actually implements the policy decisions expressed in its Report," and "will continue to be vigilant in investigating and, where necessary, prosecuting Section 2 violations." In a separate statement, Chairman William Kovacic neither endorsed nor criticized the views of his fellow Commissioners, but called instead for more discussion of, and empirical research into, the issues raised by the Justice Department Report.[3]

***William Kolasky** is a partner in WilmerHale's Regulatory and Government Affairs Department and member of the Antitrust and Competition Group.*

[1] U.S. Dep't Of Justice, Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act (Sept. 2008), *available at* http://www.usdoj.gov/atr/public/reports/236681.htm.

[2] *See* Statement of Commissioners Harbour, Leibowitz, and Rosch on the Issuance of the Section 2 Report by the Department of Justice (Sept. 8, 2008), *available at* http://www.ftc.gov/os/2008/09/080908section2stmt.pdf.

[3] *See* Statement of Federal Trade Commission Chairman William E. Kovacic, 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 (Sept. 8, 2008), *available at* http://www.ftc.gov/os/2008/09/080908section2stmtkovacic.pdf.

This disagreement between the Justice Department and FTC over how Section 2 should be enforced is unfortunate. Over nearly two decades, a broad bipartisan consensus has prevailed in support of strong antitrust enforcement, applying sound economic principles to protect competition, not competitors. This consensus now appears at risk. The Justice Department, reflecting the free market fundamentalism that has characterized Bush Administration economic policy generally, appears to seek through its Report to limit use of the antitrust laws to police single-firm conduct. The FTC, by contrast, with a strong pro-enforcement majority, seeks to broaden the application of the antitrust laws to single-firm conduct. One Commissioner, J. Thomas Rosch, for example, has argued that the Supreme Court's pro-defendant monopolization decisions—such as *Trinko*, *Weyerhaeuser*, and even *Brooke Group*—should be read narrowly in order to provide more scope for Section 2 enforcement.[4] Commissioner Rosch has also joined with Commissioners Pamela Jones Harbour and Jonathan Leibowitz in advocating broader use of the Commission's authority to outlaw single-firm conduct as an unfair method of competition under Section 5 of the FTC Act even if that conduct would not violate Section 2 of the Sherman Act.[5] The Commission did just that in its recent action against N-Data,[6] where it challenged as an unfair method of competition an effort by a patent holder to revise the terms of its commitments to a standard-setting organization several years after its technology was incorporated into an industry standard. The Commission acknowledged that this conduct did not violate Section 2, but nevertheless insisted that N-Data abide by its original commitments.

With a new Administration coming into office in January, it is difficult to predict whether the schism on Pennsylvania Avenue will continue. Barack Obama has been vocal in accusing the Bush Justice Department of having one of the weakest records of antitrust enforcement in the last half century and has promised to reinvigorate antitrust enforcement if elected. John McCain has pointed to Teddy Roosevelt as one of his heroes, citing in particular his reputation as a trustbuster who was not afraid to take on the "great malefactors of wealth" on Wall Street. One might expect that he, too, if elected, might seek to step up antitrust enforcement.

Rather than joining the political debate, it would be more constructive to step back and take an objective look at the Justice Department Report to find ways to bridge the gap. Taking that approach, even the objecting Commissioners would probably agree that the Justice Department Report does a good job analyzing particular types of exclusionary conduct, such as price predation, tying, bundled and loyalty discounts, refusals to deal, and exclusive dealing. For each type of conduct, the Report correctly identifies both the potential anticompetitive effects and procompetitive justifications, and offers useful suggestions as to how such anticompetitive effects and procompetitive justifications should be evaluated in individual cases. The principal focus of the three Commissioners' objections is not to this part of the Report, but rather to the general standard it proposes for exclusionary conduct. And, in that regard, their concerns appear to have some merit.

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4 *See* J. Thomas Rosch, A Modest Proposal for Antitrust Decisions at the Supreme Court (Mar. 27, 2008), *available at* http://www.ftc.gov/speeches/rosch/080327modest.pdf.

5 *See, e.g.*, J. Thomas Rosch, Section 2 and Standard Setting: *Rambus*, *N-Data* & The Role of Causation (Oct. 2, 2008), *available at* http://www.ftc.gov/speeches/rosch/081002section2rambusndata.pdf.

6 Negotiated Data Solutions LLC, FTC File No. 051 0094 (Sept. 23, 2008) (Decision and Order), *available at* http://www.ftc.gov/os/caselist/0510094/index.shtm; Statement of the Federal Trade Commission, In the Matter of Negotiated Data Solutions LLC, FTC File No. 051 0094 (Jan. 23, 2008), *available at* http://www.ftc.gov/os/caselist/0510094/080122statement.pdf.

The Justice Department Report proposes that allegedly exclusionary conduct by dominant and near-dominant firms should be judged using a "substantial disproportionality test." Under this test, the Justice Department would bring a case only if the conduct harms consumers and competition in a way that is "substantially disproportionate" to any legitimate benefits the monopolist or near-monopolist might realize. The Department argues that this test is superior to the three alternative tests it considered—an effects-balancing test, a no-economic-sense test, and an equally-efficient-competitor test—because it is more administrable and reduces the risk of false positives (i.e., finding conduct unlawful that does not harm competition), which the Department views as more serious than that of false negatives (i.e., finding conduct lawful that does harm competition).

The three Commissioners' objection to this "substantial disproportionality" test is that, in applying the rule of reason balancing test to single-firm conduct, it puts a finger on the scale in favor of monopolists and near-monopolists, leaving consumers and smaller competitors with too little protection. In my view, there is another, more fundamental problem with the Justice Department's proposed test—namely, it reflects an outdated view of the rule of reason as it is actually applied by the courts. As the Supreme Court explained in *California Dental Association v. FTC*,[7] the courts over the last thirty years have developed a highly structured analytical framework for applying the rule of reason, which has converted it from an ad hoc balancing test to a stepwise, sliding scale test. Under this stepwise approach, the court first examines the alleged anticompetitive effects to determine whether they are serious enough to justify shifting to the defendant the burden of having to explain its conduct. If the court finds those anticompetitive effects to be substantial, it will require the defendant to come forward with procompetitive justifications for the alleged conduct. If the defendant does so, and if those justifications withstand initial scrutiny, the court will then require the plaintiff to show that there are less restrictive alternatives that might have achieved the defendant's legitimate objectives at less cost to competition.

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At each of the last two steps in this process, the degree of scrutiny to which the court will subject the proffered justifications and less restrictive alternatives depends on the strength of the showing at the previous steps. Thus, the more serious the anticompetitive effects, the more closely the courts will scrutinize any proffered justifications. Similarly, how hard the courts will search for less restrictive alternatives, and how closely it will scrutinize them, depends on how strong the prior showings of anticompetitive effects and procompetitive justifications have been. Taking this stepwise approach, the courts rarely, if ever, actually balance the anticompetitive and procompetitive effects to determine their net impact on consumer welfare—a nearly impossible task.

As I have written elsewhere,[8] this stepwise approach to the rule of reason applies not only to concerted conduct under Section 1, but also to single-firm conduct under Section 2. When the Supreme Court first articulated the rule of reason in *Standard Oil Co. v. United States*,[9] it applied that rule to both the Section 1 and Section 2 claims against Standard Oil. And in more recent cases in which the courts of appeals have applied the rule of reason to evaluate single-firm conduct under Section 2, they have done so using the same stepwise sliding-scale approach they use for concerted conduct under Section 1.[10] The courts thereby avoid the type of ad hoc balancing the

7 526 U.S. 756, 779–81 & n.15 (1999) (citing William Kolasky, *Counterpoint: The Department of Justice's "Stepwise" Approach Imposes Too Heavy a Burden on Parties to Horizontal Agreements*, ANTITRUST, Spring 1998, at 41).

8 *See* William Kolasky, *Reinvigorating Antitrust Enforcement in the United States: A Proposal*, ANTITRUST, Spring 2008, at 85, 89.

9 221 U.S. 1 (1911).

10 *See, e.g.*, United States v. Microsoft Corp., 253 F.3d 34, 58–59 (D.C. Cir. 2001).

Justice Department Report seems so greatly to fear and which it uses to justify its "substantial disproportionality" test.

The stepwise, sliding-scale framework the courts now use to apply the rule of reason is very similar to the more structured framework the Supreme Court has developed over the last forty years to enforce the constitutional guarantees of free speech and equal protection. In the 1960s, there was a debate whether the courts should use a balancing test to protect these rights or instead develop neutral principles to enforce them. The Court resolved this debate by converting what had been an ad hoc balancing test into a more structured stepwise inquiry that looks first at the nature of the infringement and then varies the degree of scrutiny to which the court will subject the proffered governmental justifications with the seriousness of the infringement.

Because the Justice Department Report fails to acknowledge that the rule of reason has likewise evolved to a structured stepwise, sliding-scale test, its concern that the rule of reason, if applied neutrally, will produce too many false positives seems exaggerated. When one examines Section 2 decisions in the Supreme Court and courts of appeals over the last quarter century, it is hard to find evidence to support the Department's fear that false positives are more likely and more serious than false negatives. Plaintiffs have won very few Section 2 cases, and most of those wins are in cases, such as *Conwood Co. v. U.S. Tobacco Co.*[11] and *United States v. Microsoft Corp.*,[12] which most antitrust lawyers and economists agree were rightly decided. Similarly, based on my own experience in counseling clients over more than thirty years, I have seen few, if any, instances in which any client was deterred from procompetitive conduct because of fear of antitrust liability.

With a new Administration in January, we should have further discussion of the standards the agencies and courts should use in enforcing Section 2. Until then, we should treat the Justice Department's Report, not as its final word, but rather as a discussion draft, and continue to search for a common standard that both agencies could apply. That was how the European Commission presented its report on Article 82 and abuse of dominance. It is an approach that makes particularly good sense here, so that we do not have the Justice Department applying one, highly laissez-faire standard to single-firm conduct and the FTC a different, more restrictive standard. ●

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[11] 290 F.3d 768 (6th Cir. 2002).

[12] 253 F.3d 34 (D.C. Cir. 2001).