



Client Alert

Antitrust Division Withdraws Bush Administration's Report on Single-Firm Conduct

On May 11, 2009, the Antitrust Division of the Department of Justice ("DOJ"), in a speech by new Assistant Attorney General Christine A. Varney and a press release issued later in the day, formally withdrew the report entitled *Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act* ("2008 Report") that had been issued by the Division in September 2008. In doing so, it confirmed expectations that the Division will be more willing to challenge conduct by dominant firms than it had been during the Bush administration. While the changes in enforcement policy are likely to be noticeable, we do not anticipate a return to the policies of the 1960s and 1970s when almost any conduct by a dominant firm that hurt its competitors was likely to be challenged.

The 2008 Report was born in controversy. It was the culmination of hearings held jointly by the DOJ and the Federal Trade Commission ("FTC"), but the FTC did not join in the Report. To the contrary, in unusually direct language for comments on the work of fellow antitrust enforcers, three of the four FTC Commissioners condemned the report as "a blueprint for radically weakened enforcement of Section 2 of the Sherman Act."

By withdrawing the 2008 Report, the Obama DOJ put the business community on notice that dominant firm conduct will be more susceptible to challenge than it was during the Bush administration, when no new cases were brought against dominant firms by the DOJ (although some were by the FTC). This enhanced enforcement, however, will be restrained by Supreme Court decisions that protect certain conduct that was once routinely challenged as violative of Section 2 (such as low but above-cost pricing).

Ms. Varney specifically identified her disagreement with only one aspect of the 2008 Report, the so-called residual test: the standard used to judge whether conduct was anticompetitive in the absence of a specific rule governing that type of conduct. The 2008 Report indicated that the DOJ ordinarily would challenge such conduct only when its anticompetitive effects "substantially" outweighed its procompetitive effects, thereby providing a buffer zone for borderline conduct. Ms. Varney rejected the substantiality requirement, explaining that the proper test was simply whether the anticompetitive effects outweighed the procompetitive effects.

While the DOJ did not provide much detail on its Section 2 enforcement priorities when it revoked the 2008 Report, we believe that change is more likely in some areas than in others. In particular, increased enforcement seems likely with respect to:

- **Exclusive dealing agreements.** The DOJ may well challenge agreements whereby a dominant firm requires its customers to deal only with it, especially where the effect is to deny actual or potential competitors sufficient sales volume to be viable.
- **Penalizing customers that deal with a dominant firm's competitors.** Ms. Varney has referred with approval to *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951), which held that a firm's refusal to deal with customers that patronize its competitors can violate Section 2. Although this decision is decades old, it was not addressed by the rash of cases in the last two decades that have limited the reach of Section 2. The DOJ will likely be quick to challenge any such conduct.

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Antitrust/Competition Client Alert

- **Other contractual impediments to competition.** The DOJ may take action if a dominant firm imposes conditions on its customers or suppliers that impair entry or expansion by other firms, such as prohibiting the customers or suppliers from developing products that are complementary to those of the dominant firm's competitors. This was the theory underlying some of the claims in the Microsoft case.
 - **Loyalty discounts.** If a dominant firm offers "first dollar discounts" that are triggered by a customer's purchasing a sufficiently high percentage of its needs (say, 80 percent) from that firm, the DOJ may conclude that these discounts essentially force customers to buy at least that portion of their needs from the dominant firm, thus denying competitors the scale needed to enter or expand. Staggered discounts in which a customer who purchases more than a given percentage of its needs from a dominant firm receives a discount applicable only to purchases that exceed that threshold are much less likely to be challenged.
 - **Refusals to deal with competitors.** In *Verizon Communications v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (2004), the Supreme Court held that the antitrust laws rarely required a dominant firm to deal with its competitors, citing its 1985 decision in *Aspen Skiing* as being "at or near the outer boundary" in requiring such cooperation. Although *Trinko* showed little enthusiasm for *Aspen Skiing*, which upheld a jury finding that terminating an existing course of dealing with a competitor violated Section 2, Ms. Varney has referred to *Aspen Skiing* with approval, hinting that she might look for an appropriate case to argue that a dominant firm must deal with its competitors if doing so is critical to their survival. The 2005 testimony of newly appointed Deputy Assistant Attorney General Carl Shapiro before the Antitrust Modernization Commission, in which he opposed the creation of a safe harbor for refusals to deal, at least in cases in which a dominant firm "achieved or enhanced its monopoly power in significant part through previously 'open' policies [with competitors] which have since become significantly less 'open,'" lends further support to the likelihood of the DOJ's bringing a case in this area. Given *Trinko*, however, the DOJ may have great difficulty prevailing on this issue, and it thus seems likely that the Division will be selective in choosing such a case.
- In other areas, case law favorable to dominant firms renders a substantial change in enforcement policy unlikely:
- **Predatory pricing.** Predatory pricing claims against dominant firms were once common. The Supreme Court's holding in *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), that low prices that made it difficult for competitors to compete were not actionable unless they were set below some measure of the firm's costs, coupled with most courts' agreement that the relevant measure of cost was average variable cost or something similar, made these cases extremely difficult for a plaintiff to win. A flurry of predatory pricing cases by the DOJ is thus unlikely. The DOJ may, however, look for a case in an industry where determining the relevant cost poses conceptual problems, as it unsuccessfully did in the case brought against American Airlines during the Clinton administration.
 - **Predatory purchasing.** Given the Supreme Court's recent extension of the *Brooke Group* test to predatory purchasing, increased enforcement in this area is unlikely.
 - **Bundle pricing.** The Supreme Court has not addressed this issue, and there is a split in the lower courts. Nevertheless, the *LePage's* decision, in which the Third Circuit essentially held that bundle pricing by a dominant firm could be found anticompetitive whenever it helped it win sales, has been so roundly condemned that it seems unlikely to be a basis for DOJ action. Rather, the DOJ is likely to follow the 2008 Report in challenging bundle pricing only where the pricing of the "monopoly" product in the bundle would violate *Brooke Group* if the entire bundled discount is attributed to that product. (For example, if the monopoly product were priced at \$10, the competitive product were priced at \$8, and the bundle of the two products were sold for \$14, the \$4 discount for buying the

Antitrust/Competition Client Alert

two products together would be attributed to the monopoly product, meaning that the effective price of the monopoly product would be \$6, which would be problematic only if its average variable cost were \$6 or more.)

- **Price squeezes.** Given the Supreme Court's recent decision in *Pacific Bell Telephone Co. v. linkLine Communications, Inc.*, 129 S. Ct. 1109 (2009), the DOJ is unlikely to challenge a dominant firm's charging an excessive price to a competitor for an input needed to compete against the dominant firm.
- **Abuse of government process.** The *Noerr-Pennington* doctrine ordinarily immunizes a dominant firm's seeking government action—whether judicial, legislative, administrative, or executive—even when the effect is to undermine competition. The case law will make challenging such conduct difficult. The Bush administration (especially the FTC) was fairly aggressive in trying to limit the reach of the *Noerr* doctrine, and it seems unlikely that the Obama administration will push this issue much more aggressively.

Although Section 2 applies only where firms have or may obtain a dominant position in a market, companies should bear in mind that antitrust markets may be defined narrowly so that, for example, a small software company may be found to be dominant with respect to a specific type of application and a small pharmaceutical company may be found to be dominant with respect to drugs treating a specific indication through a specific mechanism of action. Accordingly, many companies will need to be sensitive to the DOJ's evolving enforcement initiatives with respect to Section 2.

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