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Department of Justice and Federal Trade Commission Clash Over Section 2 Enforcement Standards

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The Antitrust Division of the U.S. Department of Justice yesterday issued a report entitled "Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act" examining when certain types of conduct may constitute illegal monopolization under U.S. antitrust law.^[1] The report follows a series of hearings held jointly by the Department and the Federal Trade Commission ("FTC") between June 2006 and May 2007 to explore in depth the antitrust treatment of single-firm conduct.

The report describes how the Department would analyze various types of behavior under Section 2 of the Sherman Act. Notable points include:

- **Monopoly Power.** The Department reconfirmed its view that, for Section 2 purposes, 'monopoly power' must be market power that is both considerable and durable: that is, the putative monopolist must be able to '*persistently* charge prices *well above* competitive levels.' The Department will presume monopoly power if a firm has maintained a market share above 67% share for a 'significant period' with no change in sight.
- **Exclusionary Conduct Standard.** In considering the applicable standard for determining whether a monopolist has engaged in illegal exclusionary conduct, the Department rejects the use of a "Profit Sacrifice" test, which asks whether conduct is less profitable in the short run than other less-exclusionary conduct the firm could have undertaken. The report argues that use of such a test would raise concerns of enforcement error and administrability. Instead, the Department recommends the use of what it calls a 'disproportionality' test -- for Section 2 liability, the conduct must produce anticompetitive effects that are 'substantially disproportionate' to any associated pro-competitive effects.
- **Unilateral Refusal to Deal.** The Department rejects imposition of liability for a monopolist's unilateral, unconditional refusal to deal with a competitor, arguing that the long term adverse incentives, and lack of administrable relief by courts, outweigh any benefits of short term price competition created by compelling a monopolist to deal with competitors.
- **Predatory Pricing.** The Department reiterates its agreement with the Supreme Court's test in *Brooke Group v. Brown & Williamson Tobacco Corp.*^[2]: in order for Section 2 liability to attach, the putative monopolist must be selling its products at prices below "an appropriate measure" of its costs, and have a dangerous probability of recouping its short term losses once competitors are excluded. The report argues that 'average avoidable cost' is the most appropriate cost measure for most cases, and generally disfavors 'average variable cost' (used by most circuits), except when incremental output cannot be identified. The report also counsels that focusing first on the 'recoupment' prong can avoid the more difficult cost issue in some cases, and that out-of-market recoupment might be relevant.
- **Tying, Bundling and Loyalty Discounts.** The report rejects the current qualified *per se* rule against tying, noting that certain types of tying, including 'technological tying,' are likely to do more good for consumers than harm. The report states that bundling should be treated as predatory pricing, imputing the full bundle discount to the competitive product(s) in the bundle. The Department said it is also inclined to treat loyalty discounts as predatory pricing, but cautions that the practice might be anticompetitive even if the customer's purchases exceed the seller's costs. The Department therefore reserves final judgment pending further

study.

- **Exclusive Dealing.** The report announces a 'safe harbor' for exclusive dealing arrangements that foreclose less than 30% of customers to a rival. The report also downplayed the importance of the length of contract term in an exclusive dealing arrangement.

FTC Criticism

Importantly, the report does not reflect the position of the FTC, which shares Section 2 civil enforcement authority with the Department of Justice. Indeed, FTC Commissioners Harbour, Leibowitz and Rosch issued a statement sharply criticizing the report as “a blueprint for radically weakened enforcement of Section 2 of the Sherman Act.” According to these Commissioners, “[a]t almost every turn, the Department would place a thumb on the scales in favor of firms with monopoly or near-monopoly power and against other equally significant stakeholders.” After criticizing the reasoning underlying the Department’s position, the three Commissioners state that the “Department’s premises lead it to adopt law enforcement standards that would make it nearly impossible to prosecute a case under Section 2 of the Sherman Act.” Thus, the Commissioners “strongly distance [themselves] from the enforcement positions stated in the Report.” For instance, the three Commissioners were critical of the Department’s “disproportionality” standard, arguing that the proper test is simply whether anticompetitive harm “outweighs” pro-competitive benefits. The three Commissioners also criticized the Department’s “average avoidable cost” standard for predatory pricing as creating an inappropriate “safe harbor” for certain high fixed cost industries.

FTC Chairman Kovacic, in a separate statement, expressed regret that the agencies could not agree on a joint report, and suggested that the report “would have benefited from a fuller examination of the history of modern doctrine and policy,...including identifying the formative influences in the evolution of the United States’ system and assessing how those influences bear upon the future development of law and policy towards dominant firms.”^[3]

Although the FTC has not released a companion report detailing its views on these issues, the significant difference of opinion between the Department of Justice and at least three of the current FTC Commissioners suggests more aggressive enforcement of Section 2 by the FTC than appears likely by the Department of Justice.

Footnotes:

^[1]A full copy of the report can be found on the Department of Justice’s website at: <http://www.usdoj.gov/atr/public/reports/236681.pdf>.

^[2] 509 U.S. 209 (1993).

^[3] The FTC statements can be found on the FTC website at: <http://www.ftc.gov/opa/2008/09/section2.shtml>.