

# Weyerhaeuser and the Search for Antitrust's Holy Grail

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## I. Introduction

It's not often that the U.S. Supreme Court overrules a 96-year-old precedent. For that reason, the Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,<sup>1</sup> which quite properly overruled the much-maligned 1911 *Dr. Miles* decision,<sup>2</sup> must be deemed the most noteworthy antitrust decision of October Term 2006.<sup>3</sup> In the long run, though, another antitrust decision from the term may turn out to be more important. That decision is *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*,<sup>4</sup> in which the Court addressed the legal standard applicable to predatory bidding claims (i.e., claims that buyers of inputs have driven prices up higher than necessary in an attempt to drive rival input-buyers from the market and thereby enhance monopsony power).<sup>5</sup>

On first glance, the matter addressed by the *Weyerhaeuser* Court looks quite narrow: Must a plaintiff complaining of predatory bidding make the same two-part showing as a predatory pricing plaintiff?<sup>6</sup>

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<sup>1</sup>127 S. Ct. 2705 (2007).

<sup>2</sup>*Dr. Miles Med. Co. v. John D. Park & Sons*, 220 U.S. 373 (1911).

<sup>3</sup>For an account of why the *Dr. Miles* decision was wrong and *Leegin* is right, see Thom Lambert, *Dr. Miles (1911–2007)*, available at <http://www.truthonthemarket.com/2007/06/29/dr-miles-1911-2007>.

<sup>4</sup>127 S. Ct. 1069 (2007).

<sup>5</sup>See *id.* at 1075–76. Monopsony power is the flip-side of monopoly power; it is “market power on the buy side of the market.” *Id.* at 1075.

<sup>6</sup>*Id.* at 1074. The Supreme Court laid down its two part test for predatory pricing in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), in which it held that a plaintiff complaining of predatory pricing must show (1) “that the prices complained of are below an appropriate measure of [the defendant’s] costs,” *Id.* at 222, and (2) that “the [defendant] had . . . a dangerous probabilit[y] of recouping its investment in below-cost prices” by charging supra-competitive prices once its rivals were extinguished. *Id.* at 224.

In answering that narrow question in the affirmative,<sup>7</sup> however, the Supreme Court may have unwittingly weighed in on one of the most hotly disputed matters in antitrust—how to define “exclusionary conduct” under Section 2 of the Sherman Act.<sup>8</sup>

This article advances two primary claims, one descriptive and one normative. As a descriptive matter, it contends that *Weyerhaeuser* implicitly adopts one proposed definition of exclusionary conduct under Section 2 and implicitly rejects three others. As a normative matter, it argues that this is a salutary development.

The article proceeds as follows. Part II summarizes the ongoing debate over how to define exclusionary conduct under Section 2. Part III then describes *Weyerhaeuser* and explains, as a descriptive matter, why it constitutes an implicit endorsement of the “exclusion of an equally efficient rival” definition of exclusionary conduct. Part IV defends that endorsement.

## II. Proposed Definitions of “Exclusionary Conduct” Under Section 2

Section 2 of the Sherman Act, the primary antitrust provision governing unilateral conduct by dominant firms, prohibits (among other offenses) “monopolization.”<sup>9</sup> The Supreme Court has defined the monopolization offense to consist of two elements: (1) the possession of monopoly power in a relevant market, and (2) exclusionary conduct designed to attain, protect, or expand such power.<sup>10</sup> For quite some time now, courts and commentators have struggled to articulate a workable definition of exclusionary conduct.<sup>11</sup> The difficulty arises because all sorts of pro-competitive behavior is literally

<sup>7</sup>*Weyerhaeuser*, 127 S. Ct. at 1078 (“The general theoretical similarities of monopoly and monopsony combined with the theoretical and practical similarities of predatory pricing and predatory bidding convince us that our two-pronged *Brooke Group* test should apply to predatory bidding claims.”).

<sup>8</sup>15 U.S.C. § 2.

<sup>9</sup>*Id.* (“Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony. . .”).

<sup>10</sup>*United States v. Grinnell Corp.*, 384 U.S. 563, 570–71 (1966) (listing elements of monopolization under Section 2 of Sherman Act).

<sup>11</sup>See generally Herbert Hovenkamp, *Exclusion and the Sherman Act*, 72 U. Chi. L. Rev. 147 (2005).

exclusionary. For example, if Acme Inc. usurps business from its rivals by lowering its price or building a better mousetrap, it has literally excluded its rivals from some marketing opportunities, making it more difficult for them to stay in business. Yet it would be perverse to forbid price-cuts and quality enhancements. The trick for courts, then, has been to articulate some test for identifying conduct that is *unreasonably* exclusionary.

The prevailing definition of unreasonably exclusionary conduct in the case law comes from the Supreme Court's *Grinnell* decision, which defined exclusionary conduct as "the willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."<sup>12</sup> But what is "willful" acquisition of monopoly power? Practically every firm "wills" to beat out its rivals and thereby attain monopoly power.<sup>13</sup> Recognizing as much, courts have sometimes referred to exclusionary conduct as conduct other than "competition on the merits."<sup>14</sup> But what exactly is *that*? These verbal formulae are not very helpful. In the words of Professor Einer Elhauge, the judicial definitions of exclusionary conduct are "not just vague but vacuous."<sup>15</sup>

Accordingly, a generalized definition of exclusionary conduct has become the Holy Grail for antitrust scholars. Last year, the American Bar Association's *Antitrust Law Journal* published a symposium issue

<sup>12</sup>Grinnell, 384 U.S. at 570–71.

<sup>13</sup>*Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 465 (S.D.N.Y. 1996) ("Unfortunately, the *Grinnell* test is not of much assistance in resolving particular cases. Every competitor seeks to capture as much business as possible. If *Grinnell* condemns all such behavior by actual and threatened monopolists, it would condemn the proverbial inventor of the better mousetrap as well as the storied trusts of the nineteenth century.').

<sup>14</sup>See, e.g., *Monsanto Co. v. Scruggs*, 459 F.3d 1328, 1338–39 (Fed. Cir. 2006) ("To establish a section 2 violation, one must prove that the party charged had monopoly power in a relevant market and acquired or maintained that power by anti-competitive practices instead of by competition on the merits."); *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (en banc) ("Exclusionary conduct . . . not only, one, tends to impair the opportunities of . . . rivals, but also, number two, either does not further competition on the merits, or does so in an unnecessarily restrictive way.').

<sup>15</sup>Einer Elhauge, *Defining Better Monopolization Standards*, 56 *Stan. L. Rev.* 253, 255 (2003).

on the matter,<sup>16</sup> and the topic emerged repeatedly during recent joint Federal Trade Commission-Department of Justice hearings on Section 2 of the Sherman Act. Indeed, at the introductory session of those hearings, Federal Trade Commission Chairman Deborah Platt Majoras characterized the issue of how unilateral conduct should be evaluated as having “dominated our antitrust debate for several years” and as “the most heavily discussed and debated area of competition policy in the international arena.”<sup>17</sup>

At this point, four proposed definitions of exclusionary conduct appear most promising.<sup>18</sup> They are: (1) conduct that could exclude from the defendant’s market an equally efficient rival, (2) conduct that raises rivals’ costs unjustifiably, (3) conduct that enhances market power and does not create enough consumer benefit to offset that harm, and (4) conduct that would involve a sacrifice of profits (or would make “no economic sense”) but for its ability to exclude rivals.

#### A. *Excluding An Equally Efficient Rival*

Judge Posner is responsible for popularizing the first definition. In the second edition of his book, *Antitrust Law*, he defined exclusionary conduct as that which is “likely in the circumstances to exclude from the defendant’s market an equally or more efficient competitor.”<sup>19</sup> This definition comports with the typical understanding of vigorous but fair competition. A competitive race is one in which (1) each runner does his best and (2) the fastest runner wins. Any conduct that could result in a winner other than the fastest runner is literally anti-competitive. At the same time, conduct that helps a competitor

<sup>16</sup>Symposium: Identifying Exclusionary Conduct Under Section 2, 73 *Antitrust L.J.* 311 (2006).

<sup>17</sup>Transcript of Hearing, Federal Trade Commission and Department of Justice Hearings on Section 2 of the Sherman Act: Single-Firm Conduct as Related to Competition (June 20, 2006) at 10 (available at <http://ftc.gov/os/sectiontwohearings/docs/60620FTC.pdf>).

<sup>18</sup>See generally Hovenkamp, *supra* note 11, at 148–62. A fifth approach rejects the notion of a single generalized definition. See, e.g., Marina Lao, *Defining Exclusionary Conduct Under Section 2: The Case for Non-Universal Standards*, in *International Antitrust Law and Policy* 433 (2006) (Barry Hawk, ed.) (advocating different evaluative approaches for different types of potentially exclusionary conduct); Mark S. Popofsky, *Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules*, 73 *Antitrust L. J.* 435 (2006) (applying an overarching rule of reason to select distinct tests for different conduct).

<sup>19</sup>Richard A. Posner, *Antitrust Law* 194–95 (2000).

along—but could not push him ahead of his more deserving rivals—is expected. Under Posner's definition, competitors would be motivated to take all actions that would push them forward, except for those actions that could push them ahead of superior or equally competent and aggressive rivals. Each competitor would work his hardest, free from fear that he would be beaten by a less capable rival.

The definition has some support in the case law, most obviously in the law governing predatory pricing.<sup>20</sup> Under governing precedents, a plaintiff complaining of predatory pricing must prove that the defendant set its price below its cost.<sup>21</sup> Because any equally (or more) efficient rival could meet a discount that resulted in above-cost pricing, this requirement has the effect of punishing only those price cuts that could exclude equally efficient rivals. As explained below, though, the equally efficient rival test has been criticized as being under-deterrent.<sup>22</sup>

#### *B. Raising Rivals' Costs Unjustifiably*

The second prominent exclusionary conduct definition is significantly broader. That definition arises from so-called “post-Chicago” economic theories that purport to explain how dominant firms may use contracts, product innovations, or other means to impose disproportionately higher costs on their rivals.<sup>23</sup> By imposing such costs, dominant firms enable themselves to charge higher prices even if they do not completely exclude their rivals. They may do so because their competitors have become less efficient and thus less able to check higher prices.<sup>24</sup>

<sup>20</sup>The definition has also achieved some traction in the case law governing bundled discounts. See *infra* note 159 and accompanying text.

<sup>21</sup>See *supra* note 6 (summarizing two-part predatory pricing test outlined in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222–24 (1993)).

<sup>22</sup>See *infra* notes 108–15 and accompanying text.

<sup>23</sup>Hovenkamp, *supra* note 11, at 159–60. For a lucid discussion of “post-Chicago” antitrust, see Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 Colum. Bus. L. Rev. 257.

<sup>24</sup>See Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 Antitrust L.J. 311, 315 (2006) (“[Raising Rivals’ Costs] generally describes conduct to raise the costs of competitors with the purpose and effect of causing them to raise their prices or reduce their output, thereby allowing the excluding firm to profit by setting a supracompetitive price.”).

In light of these post-Chicago theories, a number of scholars advocate a definition that deems conduct exclusionary if it raises rivals' costs unjustifiably. The cost-raising must be "unjustifiable" because much pro-competitive, efficient conduct raises rivals' costs.<sup>25</sup> For example, offering a superior product or charging a lower price may usurp business from rivals, thereby reducing their scale and increasing their per-unit costs. Yet consumer-friendly design enhancements and price reductions should not be deemed exclusionary. The \$64,000 question, then, is "When is cost-raising conduct unjustifiable?"

One option is to answer that question case-by-case, based on the competitive effects of the conduct at issue.<sup>26</sup> But that approach begs the question of *which* competitive effects will render a cost-raising practice unjustifiable. In light of that difficulty, Professor Elhauge, a leading proponent of the "raising rivals' costs" approach, has proposed a more structured test that essentially defines "justifiable" increases of rivals' costs as those that result as a byproduct of the defendant's enhanced efficiency. In other words, if the defendant's conduct raises rivals' costs because it makes the defendant more efficient, the cost-raising is justifiable; if the conduct raises rivals' costs *even without* making the defendant more efficient, the cost-raising is unjustifiable.<sup>27</sup>

<sup>25</sup>See, e.g., Posner, *supra* note 19, at 196 (contending that raising rivals' costs is "not a happy formula" and observing that a primary means of raising rivals' costs is by becoming so efficient as to make one's rivals "unable to reach a level of output at which to exploit the available economies of scale").

<sup>26</sup>See, e.g., Willard K. Tom, David A. Balto & Neil W. Averitt, *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 *Antitrust L.J.* 615 (2000). The authors contend that loyalty discounts may raise rivals' costs by denying them economies of scale. *Id.* at 627–30. The authors then conclude that loyalty discounts should not be governed by straightforward predatory pricing rules but should instead be judged on a case-by-case basis. *Id.* at 638 ("Where the pricing structure, rather than the price level, is used to secure an anticompetitive result, the cost test of predatory pricing does not automatically apply. Instead, one must conduct a case-by-case analysis of the actual effects of the particular practice to determine whether anticompetitive outcomes are likely.").

<sup>27</sup>Elhauge, *supra* note 15, at 330. Professor Elhauge maintains that antitrust law should eschew "an open-ended rule of reason balancing test" for determining when cost-raising conduct is justifiable and should instead

employ[] two rules to sort out when to condemn conduct that helps acquire or maintain monopoly power. One rule makes such conduct per se legal if its exclusionary effect on rivals depends on enhancing the defendant's efficiency. The other rule makes such conduct per se illegal if its exclusionary effect on rivals will enhance monopoly power regardless of any improvement in defendant efficiency.

As explained below, even the more structured versions of the raising rivals' costs approach are likely to be exceedingly difficult to administer and intolerably indeterminate.<sup>28</sup>

C. *The Consumer Welfare Effect Test (A "Market-Wide Balancing" Approach)*

A third set of tests for exclusionary conduct focuses on the challenged act's net effect on consumer welfare.<sup>29</sup> The most prominent version of this sort of test appears in the Areeda-Hovenkamp treatise, the leading antitrust treatise, which defines exclusionary conduct as acts that:

- (1) are reasonably capable of creating, enlarging or prolonging monopoly power by impairing the opportunities of rivals; and
- (2) that either (2a) do not benefit consumers at all, or (2b) are unnecessary for the particular consumer benefits that the acts produce, or (2c) produce harms disproportionate to the resulting benefits.<sup>30</sup>

Some commentators have referred to this sort of test as a "market-wide balancing" approach, for all the "action," from a practical standpoint, occurs in part 2c.<sup>31</sup> Challenges to conduct that failed to meet the first element would be immediately dismissed, and parts 2a and 2b deal with easy cases involving harm without benefit.<sup>32</sup> Because generalized definitions of exclusionary conduct are likely to be invoked only when the conduct at issue involves a mixed bag of pro-competitive benefits and anti-competitive harms, application of the test will almost always come down to balancing harms and benefits.

<sup>28</sup>See *infra* notes 125–29 and accompanying text.

<sup>29</sup>See, e.g., Salop, *supra* note 24, at 329–57 (arguing for a "consumer welfare effect test"); Hovenkamp, *supra* note 11, at 148–51 (arguing for test that similarly focuses on a practice's net effects on consumers).

<sup>30</sup>Phillip E. Areeda & Herbert Hovenkamp, 3 *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶ 651a at 72 (2d ed. 2002).

<sup>31</sup>See, e.g., A. Douglas Melamed, *Exclusive Dealing Agreements and Other Exclusionary Conduct—Are There Unifying Principles?*, 73 *Antitrust L.J.* 375, 379 (2006).

<sup>32</sup>*Id.* at 380 (explaining why the Areeda-Hovenkamp test requires market-wide balancing in all cases in which a generalized test for exclusionary conduct would be helpful—i.e., those cases that involve "conduct that creates both efficiency benefits and exclusionary harm").

So construed, the Areeda-Hovenkamp definition is troubling for a couple of reasons. First, market-wide balancing of the various effects of mixed bag conduct is extremely difficult and would likely exceed the competence of courts and enforcement agencies. As Douglas Melamed recently observed, balancing the benefits and harms of efficiency-creating but exclusion-causing conduct would require courts to (1) “quantify[] both welfare effects by estimating price, cost, and quantity of output under two conditions—before and after exclusion of rivals”; (2) “deal[] with the time dimension (both duration and discounting to present value) of each”; and (3) “compare[] both to a hypothetical but-for world in which the conduct did not take place.”<sup>33</sup> Such an inquiry would be next to impossible. In addition, a consumer welfare effect test would provide businesses with little *ex ante* guidance regarding the legality of proposed courses of conduct and is therefore likely to deter efficiency-enhancing, but novel, practices.<sup>34</sup>

#### D. The “No Economic Sense” Test

Whereas the approaches discussed above attempt to *define* exclusionary conduct—that is, to specify what it is about challenged conduct that makes it unreasonably exclusionary—the final approach seeks merely to *identify* such conduct. In other words, the approach abandons the Platonic quest for the essence of “unreasonable exclusionariness” and instead merely posits a test that will

<sup>33</sup>*Id.* at 381; see also Gregory J. Werden, Identifying Exclusionary Conduct Under Section 2: The “No Economic Sense” Test, 73 Antitrust L.J. 413, 431 (2006) (“Even if economists could perfectly sort out the relatively short-run economic consequences of all marketplace conduct, they still could not accurately account for the important long-term effects of any remedial action on incentives for innovation and risk taking—the twin engines of our prosperity.”).

<sup>34</sup>As Douglas Melamed recently argued:

The balancing test would require a firm to determine, before it embraces new competitive strategies, not just the impact of the strategies on its business, but also the impact on rivals and to weigh the benefits to its consumers against the long-run harm to consumers if the firm’s less-inventive rivals are weakened or driven from the market as a result. Assessing the long-run harm would require, among other things, calculating the duration of the harm in light of responses by competitors, new entry, and future innovation. Melamed, *supra* note 31, at 381. Given the near impossibility of this inquiry and the high cost of making a mistake (i.e., an adverse treble damages judgment), firms would likely forgo aggressive new methods of competition to the detriment of consumers.



identify conduct that is unreasonably exclusionary without saying what it is about the conduct that makes it so.

Early versions of this identifying (as opposed to defining) approach focused on profit sacrifice: conduct was tagged as unreasonably exclusionary if (but not because) it involved a sacrifice of immediate profits as part of a strategy whose profitability depended on the exclusion of rivals.<sup>35</sup> A purported benefit of a sacrifice-based approach is its administrability; proponents maintain that it can be easily applied both by courts and regulators analyzing past conduct and by firms and antitrust counselors analyzing proposed conduct.<sup>36</sup>

Despite this virtue, Professor Hovenkamp has criticized the traditional profit sacrifice test for being both over- and under-inclusive.<sup>37</sup> It is over-inclusive, he argues, because it would condemn some clearly pro-competitive conduct, such as new product development.<sup>38</sup> Hovenkamp offers the example of a firm that invests heavily in designing a new mousetrap that, when marketed, will drive out the competition. Such innovation, which would appear to involve an immediate profit sacrifice that leads to monopoly, obviously should not be condemned under the antitrust laws.<sup>39</sup> On the other hand, Hovenkamp maintains, the test is under-inclusive because it would fail to condemn various acts of monopoly maintenance (such as certain tying and exclusive contracts) that “may be profitable the instant they are in place yet also anticompetitive.”<sup>40</sup>

<sup>35</sup>See, e.g., Janusz A. Ordover & Robert D. Willig, *An Economic Definition of Predation: Pricing and Product Innovation*, 91 *Yale L.J.* 8 (1981); Robert H. Bork, *The Antitrust Paradox: A Policy at War With Itself* 144 (1978).

<sup>36</sup>See, e.g., Melamed, *supra* note 31, at 393 (“Perhaps most important, the sacrifice test provides simple, effective, and meaningful guidance to firms so that they will know how to avoid antitrust liability without steering clear of procompetitive conduct.”); Werden, *supra* note 33, at 415 (“Application of the no economic sense [variant of the profit sacrifice] test is conceptually straightforward.”).

<sup>37</sup>See Herbert Hovenkamp, *The Antitrust Enterprise: Principle and Execution* 152–54 (2005); Hovenkamp, *supra* note 11, at 155–58.

<sup>38</sup>Hovenkamp, *supra* note 11, at 158 (“All innovation is costly, and many successful innovations succeed only because consumers substitute away from rivals’ older versions and toward the innovator’s version. . . . As a result, willingness to ‘sacrifice’ short-term profits in anticipation of later monopoly profits does not distinguish anticompetitive from procompetitive uses of innovation.”).

<sup>39</sup>Hovenkamp, *supra* note 37, at 152.

<sup>40</sup>*Id.* As an example of immediately profitable exclusionary devices, Hovenkamp points to “tying and exclusive dealing contracts, such as Microsoft’s insistence that Windows users also take Internet Explorer.” *Id.*

Perhaps seeking to avoid these sorts of criticisms, some proponents of a sacrifice-based test for identifying exclusionary conduct have refined the test a bit.<sup>41</sup> The version of the test advocated by the U.S. Department of Justice, for example, provides that “conduct is not exclusionary or predatory unless it would make no economic sense for the defendant but for its tendency to eliminate or lessen competition.”<sup>42</sup> So construed, the test avoids Hovenkamp’s concerns about its over- and under-inclusivity. The argument that the test is “too broad” because it would condemn investments in innovation assumes that it is sufficient to ask whether the defendant’s conduct entails a short run profit sacrifice. The “no economic sense” test, though, would require more: upon finding a short-run sacrifice, one must ask why it would be rational to make that sacrifice.<sup>43</sup> If there’s a profit-enhancing rationale (some “economic sense”) besides a lessening of competition, then the test is not satisfied.<sup>44</sup>

Hovenkamp’s argument that the test is “too narrow” because it would fail to condemn immediately profitable anticompetitive acts similarly dissolves if the test is “no economic sense.” Whereas the profit sacrifice test seemed to require two time periods—a short run period in which there are losses followed by a later period in which there is monopoly recoupment—the “no economic sense” test focuses on the nature of the conduct and asks merely whether it would reduce profits but for its tendency to eliminate competition. The key question is not when the conduct will be profitable but why it is (or is expected to be) profitable.<sup>45</sup> So construed, the test condemns

<sup>41</sup>See generally Melamed, *supra* note 31; Werden, *supra* note 33.

<sup>42</sup>See, e.g., Brief for the United States and the FTC as Amici Curiae Supporting Petitioner at 15, *Verizon Commc’ns, Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (2004) (No. 02-682), available at <http://www.ftc.gov/os/2003/05/trinkof.pdf> (emphasis omitted).

<sup>43</sup>See Werden, *supra* note 33, at 424 (“When the defendant’s conduct entails a short-run profit sacrifice, the no economic sense test further asks why it is rational to make that sacrifice.”).

<sup>44</sup>Hovenkamp’s mousetrap example, see *supra* note 39 and accompanying text, would therefore fail. While “invest[ing] heavily in designing a better mousetrap” may entail a short run profit sacrifice, the rationality of that sacrifice does not depend on the elimination of rivals; the sacrifice would be economically rational if it were expected to result in a superior mousetrap for which consumers would be willing to pay a higher price.

<sup>45</sup>See Melamed, *supra* note 31, at 391 (observing that it is “incorrect” to interpret the profit-sacrifice test as holding that “conduct is anticompetitive only if it entails losses in the short run followed by monopoly recoupment in some later period”; rather, “the test depends, not on the timeline, but rather on the nature of the conduct—on whether it would make no business or economic sense but for its likelihood of harming competition”).

practices that, in Hovenkamp's words, "may be profitable the instant they are in place, yet also anticompetitive."<sup>46</sup>

### **III. The *Weyerhaeuser* Decision and Its Implications for the Definitional Debate**

When one considers the *Weyerhaeuser* decision in light of this ongoing debate over how to define exclusionary conduct, the decision's importance becomes apparent. The Supreme Court, it seems, has weighed in on the definitional question.

#### *A. The Weyerhaeuser Decision*<sup>47</sup>

The plaintiff in *Weyerhaeuser*, Ross-Simmons, operated a hardwood lumber sawmill in Longview, Washington. It purchased many of the red alder sawlogs it processed on the open bidding market, competing for such purchases with Weyerhaeuser, the defendant. Weyerhaeuser eventually grew to be substantially larger than Ross-Simmons and by 2001 was acquiring about 65% of the alder logs available for sale in the region.<sup>48</sup>

Ross-Simmons accused Weyerhaeuser of "predatory bidding." Specifically, claimed Ross-Simmons, Weyerhaeuser bought more alder sawlogs than it needed and bid up the price for alder sawlogs higher than necessary to attain the quantity it required.<sup>49</sup> This had the effect of raising the cost of Ross-Simmons' key input. At the same time, Weyerhaeuser did not increase the price of its output; market prices for finished hardwood lumber actually fell.<sup>50</sup> This created a revenue squeeze: the sawmills' revenues (reflecting market prices of finished hardwood) fell, even as the sawmills' costs (reflecting the unnecessarily high price of the most important input) were rising. After enduring this squeeze for several years, Ross-Simmons shut down its mill completely in 2001.<sup>51</sup> Blaming Weyerhaeuser for

<sup>46</sup>Hovenkamp, *supra* note 37, at 152.

<sup>47</sup>*Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007).

<sup>48</sup>*Id.* at 1072.

<sup>49</sup>*Id.* at 1073.

<sup>50</sup>*Id.*

<sup>51</sup>*Id.*

its failure, Ross-Simmons sued the company for monopolization and attempted monopolization under Sherman Act Section 2.<sup>52</sup>

Weyerhaeuser unsuccessfully moved for summary judgment, and then, after trial, sought judgment as a matter of law or, alternatively, a new trial.<sup>53</sup> The district court denied both requests.<sup>54</sup> It also rejected Weyerhaeuser's proposed "predatory bidding" jury instruction, which incorporated the predatory pricing elements set forth in the Supreme Court's *Brooke Group* decision.<sup>55</sup> That decision held that a plaintiff complaining of predatory pricing must establish that (1) "the prices complained of are below an appropriate measure of its rival's costs,"<sup>56</sup> and (2) "a dangerous probability" existed that the rival would later "recoup[] its investment in below-cost prices" once it stopped such pricing.<sup>57</sup> Weyerhaeuser argued that the jury should be instructed that overbidding for sawlogs could be anticompetitive conduct only if it resulted in Weyerhaeuser's operating at a loss and a dangerous probability of its recoupment of losses existed.<sup>58</sup> The district court rejected Weyerhaeuser's proposed instruction and instead told the jury it could find an anticompetitive act if it concluded that Weyerhaeuser "purchased more logs than it needed or paid a higher price for logs than necessary, in order to prevent [Ross-Simmons] from obtaining the logs they needed at a fair price."<sup>59</sup>

<sup>52</sup> 15 U.S.C. § 2. Specifically, Ross-Simmons maintained that Weyerhaeuser had used "its dominant position in the alder sawlog market to drive up the prices for alder sawlogs to levels that severely reduced or eliminated the profit margins of Weyerhaeuser's alder sawmill competition." Weyerhaeuser, 127 S. Ct. at 1073.

<sup>53</sup> Weyerhaeuser, 127 S. Ct. at 1073.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222 (1993).

<sup>57</sup> *Id.* at 224.

<sup>58</sup> Weyerhaeuser, 127 S. Ct. at 1073.

<sup>59</sup> *Id.* The district court gave the following instruction regarding anticompetitive conduct:

Anti-competitive conduct is conduct that has the effect of wrongly preventing or excluding competition, or frustrating or impairing the efforts of other firms to compete for customers within the relevant market, making it very difficult or impossible for competitors to engage in fair competition. Not everything that enables a company to gain or maintain a monopoly is anti-competitive.

In deciding whether conduct is anti-competitive, you should consider whether the conduct lacks a valid business purpose, or unreasonably or unnecessarily impedes the efforts of other firms to compete for raw materials

Concluding that Ross-Simmons had proven monopolization, the jury returned a \$26 million verdict, which was trebled to approximately \$79 million.<sup>60</sup>

Weyerhaeuser appealed to the U.S. Court of Appeals for the Ninth Circuit, arguing that *Brooke Group's* requirements for predatory pricing should similarly apply to predatory bidding claims.<sup>61</sup> The Ninth Circuit disagreed.<sup>62</sup> It reasoned that predatory bidding, while conceptually similar to predatory pricing, does not necessarily produce the same consumer benefit—lower prices for at least the short-term.<sup>63</sup> The court concluded that “the concerns that led the *Brooke Group* Court to establish a high standard of liability in the predatory pricing context do not carry over to this predatory bidding context with the same force,” so the *Brooke Group* standards for predatory pricing liability should not apply to claims of predatory bidding.<sup>64</sup>

In an 8-0 decision authored by Justice Thomas, the Supreme Court reversed the Ninth Circuit and held that *Brooke Group's* standard of liability does apply to predatory bidding claims.<sup>65</sup> The Court's holding was based on the similarity between predatory pricing and predatory bidding.<sup>66</sup> Both practices involve an attempt to attain market power—i.e., the power to enhance one's profits by affecting

or customers, or if the anticipated benefits of the conduct flow primarily from its tendency to hinder or eliminate competition. Anti-competitive conduct does not include ordinary means of competition, such as offering better products or services, exercising superior skill or business judgment, utilizing more efficient technology, better marketing, or exercising natural competitive advantages such as unique geographic access to raw materials or markets.

....

One of Plaintiffs' contentions in this case is that the Defendant purchased more logs than it needed or paid a higher price for logs than necessary, in order to prevent the Plaintiffs from obtaining the logs they needed at a fair price. If you find this to be true, you may regard it as an anti-competitive act.

*Confederated Tribes of Siletz Indians of Ore. v. Weyerhaeuser Co.*, 411 F.3d 1030, 1039 n.30 (9th Cir. 2005), vacated by *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007).

<sup>60</sup>Weyerhaeuser, 127 S. Ct. at 1073.

<sup>61</sup>*Id.*

<sup>62</sup>Weyerhaeuser, 411 F.3d at 1035–36.

<sup>63</sup>*Id.* at 1037.

<sup>64</sup>*Id.* at 1038.

<sup>65</sup>Weyerhaeuser, 127 S. Ct. at 1074.

<sup>66</sup>*Id.* at 1078.

prices.<sup>67</sup> Whereas predatory pricing may permit a firm to attain monopoly power (the power to drive output prices upward by withholding one's production), predatory bidding may enable a firm to attain monopsony power—the power to drive input prices (and thus the firm's costs) downward by cutting back on one's purchases.<sup>68</sup> Exercises of both types of market power result in allocative inefficiency—the wealth loss that occurs when resources, because of price distortions, are not directed toward their highest and best uses.<sup>69</sup> Thus, the Court concluded, “[p]redatory-pricing and predatory-bidding are analytically similar.”<sup>70</sup>

Moreover, claims of predatory-pricing and predatory-bidding involve “strikingly similar allegations.”<sup>71</sup> A predatory-pricing plaintiff alleges that the defendant reduced the price of its product in order to drive competing sellers out of business so that the defendant, insulated from selling competition, could then raise its prices above competitive levels. A predatory-bidding plaintiff alleges that the defendant deliberately bid up the price of a key input in order to drive competing buyers out of business so that the defendant, insulated from buying competition, could then cut back on its input purchases and thereby drive down the price of inputs. Both strategies “logically require firms to incur short-term losses on the chance that they might reap supracompetitive profits in the future.”<sup>72</sup>

Finally, the Court observed, “predatory bidding mirrors predatory pricing in respects that [the Court] deemed significant to [its] analysis in *Brooke Group*.”<sup>73</sup> First, because both schemes require certain losses and provide only speculative chances of future supracompetitive profits, each is “rarely tried, and even more rarely successful.”<sup>74</sup> In addition, the specific activities taken in connection with the two schemes—output-discounting and input-stockpiling—may each

<sup>67</sup> *Id.* at 1075.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.* at 1076.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at 1077.

<sup>74</sup> *Id.* (quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993) (quoting *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986))).

have pro-competitive effects.<sup>75</sup> Discounting benefits consumers and wins business for the discounter, and stockpiling inputs may provide “a hedge against the risk of future rises in input costs or future input shortages.”<sup>76</sup> Finally, both practices *may* benefit consumers in the long-term: predatory pricing may do so if recoupment attempts fail because of entry, and predatory bidding may do so if “the acquisition of more inputs leads to the manufacture of more outputs.”<sup>77</sup>

Thus, the Court concluded, the similarities of predatory-pricing and predatory-bidding warrant an identical liability standard—the *Brooke Group* standard—for both types of conduct.<sup>78</sup> Applied in the predatory bidding context, the first prong of that standard requires a plaintiff to prove that “the predator’s bidding on the buy side . . . caused the cost of the relevant output to rise above the revenues generated in the sale of those outputs.”<sup>79</sup> To satisfy the second prong, the plaintiff must establish “that the defendant has a dangerous probability of recouping the losses incurred in bidding up input prices through the exercise of monopsony power.”<sup>80</sup> Because Ross-Simmons had conceded that it could not satisfy these standards, its monopolization claim failed.<sup>81</sup>

*B. Implications of Weyerhaeuser for a Generalized Definition of Exclusionary Conduct*

On first glance, *Weyerhaeuser* would seem to be of little practical significance. As the Supreme Court noted, the specific practice to which the decision speaks is rarely attempted.<sup>82</sup> The apparent narrowness of the *Weyerhaeuser* decision, though, is likely deceiving. In

<sup>75</sup> *Weyerhaeuser*, 127 S. Ct. at 1077 (“Just as sellers use output prices to compete for purchasers, buyers use bid prices to compete for scarce inputs. There are myriad legitimate reasons—ranging from benign to affirmatively procompetitive—why a buyer might bid up input prices.”).

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* at 1078.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* (“Ross-Simmons has conceded that it has not satisfied the *Brooke Group* standard.”).

<sup>82</sup> *Id.* at 1077.

its reasoning, if not its precise holding, the *Weyerhaeuser* Court took sides in what is perhaps the greatest debate in contemporary anti-trust—how to define exclusionary conduct. By holding that Ross-Simmons’ evidence could not, as a matter of law, establish exclusionary conduct, the Court implicitly rejected the sacrifice-based, consumer welfare effect, and raising rivals’ costs tests for exclusionary conduct and implicitly endorsed Judge Posner’s equally efficient rival test. That’s because the first three tests, but not the last, would have deemed *Weyerhaeuser*’s conduct exclusionary.

### 1. *Sacrifice-Based Tests*

First consider how *Weyerhaeuser* would have fared under the profit sacrifice test and its “no economic sense” variant. Under that test, the relevant question would have been whether there was sufficient evidence to uphold a conclusion that *Weyerhaeuser*’s conduct would have been unprofitable—i.e., would have made “no economic sense”—but for an enhancement in *Weyerhaeuser*’s market power. Thus, the jury would have been required to compare *Weyerhaeuser*’s pre-overbidding profits with what its profits would have been had it engaged in overbidding without experiencing an enhancement of monopsony power; if the former figure were found to exceed the latter, the conduct would have been exclusionary.<sup>83</sup>

Without doubt, the record supported a conclusion that *Weyerhaeuser*’s conduct would not have been profit-enhancing but for the fact that it enhanced the firm’s monopsony power. As the Ninth Circuit emphasized,

<sup>83</sup> Professor Salop explains how the sacrifice-based tests operate as follows:

The profit-sacrifice test examines the profitability of the defendant’s conduct relative to a hypothetical market outcome that is used as the non-exclusionary benchmark. The hypothetical “but for” marketplace is one in which it is impossible to raise prices following the exclusionary conduct. When exclusionary conduct potentially raises barriers to competition in some way, a defendant’s exclusionary conduct can be said to sacrifice profits if the conduct would have been unprofitable (and, thus, likely not undertaken) in the absence of those enhanced barriers to competition.

Salop, *supra* note 24, at 319. Professor Salop notes that the traditional profit sacrifice test and its no economic sense variant both involve this inquiry. The primary difference between the two is that the latter “does not require a showing that there is a period of time in which the defendant’s profits are lower than they were before the exclusionary conduct was undertaken”; thus, “[t]he reduction in profits can be conceptual rather than temporal.” *Id.* at 319–20.



## *Weyerhaeuser and the Search for Antitrust's Holy Grail*

One of Weyerhaeuser's former senior analysts, Eugene Novak . . . authored a memorandum regarding the costs of sawlogs and lumber in which he stated that the increase in sawlog prices despite Weyerhaeuser's predominant market share made no sense. Novak estimated that, due to the excessive prices Weyerhaeuser paid for sawlogs, it "had given up some \$40 to \$60 million dollars in the last three years." He testified that his boss, Vicki McInnally, who was a member of the senior management team, told him that "that was the strategy that [Weyerhaeuser] designed."<sup>84</sup>

Given such evidence, a reasonable jury certainly could have concluded that Weyerhaeuser's conduct was exclusionary under a profit sacrifice or no economic sense tests.

This point was emphasized to the Supreme Court. For example, the American Antitrust Institute's amicus brief in support of Ross-Simmons observed that

[Weyerhaeuser's] purchase of "more logs than it needed" and paying "a higher price for logs than necessary" are, as the jury found, practices that satisfy both the sacrifice test and the no economic sense test. Indeed, how could buying more than necessary ever be sensible, efficient or otherwise legitimate profit-maximizing conduct? Again, as the court of appeals recognized, evidence from petitioner's own officials and documents precluded any finding of a valid business purpose for this overbuying and overpaying.<sup>85</sup>

This no doubt overstates things a bit. As an amicus brief by a group of economists emphasized, "overbidding" of the sort Weyerhaeuser engaged in could be a profit-enhancing move.<sup>86</sup> But under the Supreme Court's ruling, Ross-Simmons' claim would have failed *even if* Ross-Simmons had proven that Weyerhaeuser's conduct could

<sup>84</sup>Confederated Tribes of Siletz Indians of Ore. v. Weyerhaeuser Co., 411 F.3d 1030, 1042 (9th Cir. 2005), vacated and remanded by Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069 (2007) (alteration in orig.).

<sup>85</sup>Brief for the American Antitrust Institute as Amicus Curiae in Support of Respondent at 8, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069 (2007) (No. 05-381), available at 2006 WL 2950593.

<sup>86</sup>See Brief of Economists as Amici Curiae in Support of Petitioner at 9–11, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc., 127 S. Ct. 1069 (2007) (No. 05-381), available at 2006 WL 2459522.

not have been calculated to enhance the company's profits. Even if there were no possible way the overbidding could have benefited Weyerhaeuser but for its ability to exclude rivals, the overbidding would not have been exclusionary unless it resulted in below-cost pricing in the output market.<sup>87</sup>

## 2. *The Consumer Welfare Effect Test*

The consumer welfare effect test similarly would have resulted in a decision for Ross-Simmons. Under the Areeda-Hovenkamp version of that test, a factfinder first determines whether a challenged practice is "reasonably capable of creating, enlarging, or prolonging monopoly [or monopsony] power by impairing the opportunities of rivals."<sup>88</sup> Without doubt, the sort of overbidding with which Weyerhaeuser was charged was "reasonably capable" of enhancing the firm's monopsony power by impairing its competitors in the input market.<sup>89</sup> The second step of the Areeda-Hovenkamp test, then, is designed to ensure that this enhancement of market power is not offset by some benefit to consumers: the plaintiff must show that the challenged practice either "do[es] not benefit consumers at all," or is "unnecessary for the particular consumer benefits that the act[] produce[s]," or "produce[s] harms disproportionate to the resulting benefits."<sup>90</sup> There was almost certainly evidence in the record to support a jury conclusion that one of these three prongs (most likely, the second or third) was satisfied. While overbidding may provide

<sup>87</sup>Weyerhaeuser, 127 S. Ct. at 1078 ("A plaintiff must prove that the alleged predatory overbidding led to below-cost pricing of the predator's outputs.").

<sup>88</sup>3 Areeda & Hovenkamp, *supra* note 30, ¶ 651a, at 72.

<sup>89</sup>The Supreme Court conceded as much:

A predatory bidder ultimately aims to exercise the monopsony power gained from bidding up input prices. To that end, once the predatory bidder has caused competing buyers to exit the market for purchasing inputs, it will seek to "restrict its input purchases below the competitive level," thus "reduc[ing] the unit price for the remaining inputs it purchases." . . . The reduction in input prices will lead to "a significant cost saving that more than offsets the profit[s] that would have been earned on the output." If all goes as planned, the predatory bidder will reap monopsonistic profits that will offset any losses suffered in bidding up input prices.

Weyerhaeuser, 127 S. Ct. at 1075–76 (quoting Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 *Antitrust L. J.* 669, 672 (2005)).

<sup>90</sup>3 Areeda & Hovenkamp, *supra* note 30, ¶ 651a, at 72.

benefits for consumers, a point emphasized in the economists' brief,<sup>91</sup> the jury apparently concluded that any such benefits were minor and incidental. Indeed, it was instructed that it should consider whether the conduct had "a valid business purpose," that "offering better products or services" could not be anti-competitive, and that the overbidding could be anti-competitive if it was done "in order to prevent the Plaintiffs from obtaining the logs they needed at a fair price."<sup>92</sup> It seems, then, that the jury determined that the harms from Weyerhaeuser's monopsony-enhancing conduct were disproportionate to the resulting consumer benefits.<sup>93</sup>

In any event, there can be no doubt that the Supreme Court's ruling rejects the consumer welfare effect test. Under the test laid down by the Court, *even if* Ross-Simmons had shown that Weyerhaeuser's overbidding drove rivals out of business, was not calculated to benefit consumers in any way whatsoever, and in fact did not produce an iota of consumer benefit, Ross-Simmons still would have lost unless it had also shown that the input overbidding resulted in a below-cost price for Weyerhaeuser's finished product.<sup>94</sup>

### 3. Raising Rivals' Costs Unjustifiably

If the Supreme Court believed exclusionary conduct is that which unjustifiably raises rivals' costs, then it surely would have sustained

<sup>91</sup> See Brief of Economists as Amici Curiae, *supra* note 86, at 9–11.

<sup>92</sup> See *Confederated Tribes of Siletz Indians of Ore. v. Weyerhaeuser Co.*, 411 F.3d 1030, 1039 n.30 (9th Cir. 2005) (quoting jury instruction), (vacated by *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 127 S. Ct. 1069 (2007)).

<sup>93</sup> Again, the American Antitrust Institute emphasized this point to the Weyerhaeuser Court:

[T]he jury was required to *rule out* such theoretical procompetitive explanations for petitioner's conduct before it could find against petitioner. More specifically, the jury was instructed to determine (a) whether petitioner purchased more logs than necessary "in order to prevent" plaintiffs from meeting their input needs; and (b) whether petitioner's conduct "lacks a valid business purpose." . . . Given these instructions, the jury plainly rejected petitioner's contention that it bid up prices or increased its purchases for procompetitive reasons.

Brief of American Antitrust Institute as Amicus Curiae, *supra* note 85, at 3 (emphasis in orig.).

<sup>94</sup> *Weyerhaeuser*, 127 S. Ct. at 1078 (to create liability, "the predator's bidding on the buy side must have caused the cost of the relevant output to rise above the revenues generated in the sale of those outputs.").

the jury verdict in favor of Ross-Simmons. Weyerhaeuser's overbidding obviously drove up the price of an input its rivals used and thereby raised their costs.<sup>95</sup> The key question is whether that cost-raising was justifiable. If justifiability were determined on a case-by-case basis,<sup>96</sup> the jury verdict would seem unassailable—the Supreme Court would not question a jury's decision on an "all things considered" matter. Affirmation would also have been required under the more structured approach proposed by Professor Elhaug.<sup>97</sup> He would define exclusionary conduct as that which "would further monopoly [here, monopsony] power by impairing the efficiency of rivals *even if the defendant did not successfully enhance its own efficiency.*"<sup>98</sup> In other words, if the impairment of rivals' efficiency is not an inevitable byproduct of the perpetrator's improvement of its own efficiency, then the cost-raising is unjustified.<sup>99</sup> Here, Ross-Simmons' costs would have been raised by Weyerhaeuser's overbidding even if that over-bidding did not enhance Weyerhaeuser's efficiency. Thus, the cost-raising would have been unjustified, and the over-bidding would have been exclusionary.<sup>100</sup>

Regardless of whether the jury actually found that Weyerhaeuser's raising of rivals' costs was unjustified, it is clear that even an express and fully supported jury finding that Weyerhaeuser had *no* pro-competitive justification for its rival-impairing conduct would not have helped Ross-Simmons. The Court essentially said that even if the jury found that Weyerhaeuser had raised its rivals costs for no good reason whatsoever, Ross-Simmons still would have lost unless

<sup>95</sup>*Id.* at 1073 (citing record evidence showing that Weyerhaeuser's bidding activity had raised rivals' costs).

<sup>96</sup>See *supra* note 26 and accompanying text (discussing approach that would determine justifiability of raising rivals' costs on a case-by-case basis).

<sup>97</sup>See *supra* notes 27 and accompanying text (discussing Professor Elhaug's test for determining when raising rivals' costs is justifiable).

<sup>98</sup>Elhaug, *supra* note 15, at 256 (emphasis supplied).

<sup>99</sup>*Id.* (arguing that the only tolerable conduct that raises rivals' costs is that which "successfully impair[s] rival efficiency only as a byproduct of the defendant improving its own efficiency").

<sup>100</sup>The jury was instructed that it could find an anti-competitive act if it concluded that Weyerhaeuser engaged in overbidding "in order to" hurt Ross-Simmons by raising its input costs. See *supra* notes 59. The jury thus appeared to find that the cost-raising was not an incidental result of otherwise efficiency-enhancing conduct; it was the intended result of the conduct. See *supra* note 93. Surely that could not be a "justifiable" instance of raising rivals' costs.

it could have shown that Weyerhaeuser's conduct resulted in below-cost prices for its finished product.<sup>101</sup>

4. *Modus tollendo tollens*<sup>102</sup>

A straightforward *modus tollens* argument therefore demonstrates the Court's rejection of the sacrifice-based, consumer welfare effect, and raising rivals' costs tests for exclusionary conduct.<sup>103</sup>

- If the essence of "exclusionariness" is either (1) failure to enhance profits but for an enhancement of market power, or (2) a reduction in consumer welfare occasioned by enhanced market power, or (3) raising rivals' costs unjustifiably, then Weyerhaeuser's conduct was unreasonably exclusionary.
- Weyerhaeuser's conduct was not unreasonably exclusionary.
- Therefore, neither the sacrifice-based tests, nor the consumer welfare effect standard, nor the raising rivals' costs approach determines whether conduct is unreasonably exclusionary for purposes of Section 2.

5. *Equally Efficient Rival*

*Weyerhaeuser* is fully consistent, though, with a test that determines whether conduct is exclusionary for purposes of Section 2 by asking whether the conduct could exclude an equally efficient rival. If a defendant who pays more for an input than the amount necessary to obtain it still charges an above-cost price for whatever output he sells, then any equally efficient seller of the same output could afford to pay the same price for the input. Such a seller would not be driven out of business by the overbidding. By contrast, if a defendant's overbidding results in a below-cost price for his product, then an equally efficient rival could not meet the discount without similarly pricing below cost and might thus be driven out of business by the overbidding. If the defendant's overbidding results in an output price equal to its cost of producing the output, then all equally or more efficient rivals could afford to pay the input price (and would

<sup>101</sup> *Weyerhaeuser*, 127 S. Ct. at 1078 (holding that there can be no antitrust liability based on predatory overbidding absent proof that the defendant's overbidding resulted in a below-cost price for its finished products).

<sup>102</sup> "Mode that denies by denying."

<sup>103</sup> A *modus tollens* argument follows the following form: If P, then Q; not Q; therefore, not P.

thus stay in business) and all less efficient rivals could not afford to do so (and would be excluded). Because *Weyerhaeuser's* line of illegality appears at precisely the point at which the conduct at issue could exclude an equally efficient rival, the decision is consistent with Judge Posner's proposed test for exclusionary conduct.

#### IV. Should Exclusion of an Equally Efficient Rival Be Required for Section 2 Liability?

So far, this article's analysis has been entirely descriptive—I have shown simply that *Weyerhaeuser's* reasoning implicitly rejects the sacrifice-based, consumer welfare balancing, and raising rivals' costs tests for exclusionary conduct under Sherman Act Section 2 and implicitly endorses Judge Posner's equally efficient rival approach. I turn now to the normative question of whether this development is a good one.

On the whole, it is. While a rule requiring proof that a practice could exclude an equally efficient rival is somewhat underdeterrent,<sup>104</sup> it is also much easier to apply in the context of litigation and far less likely to result in false positives.<sup>105</sup> Such a rule is therefore less likely to deter "mixed bag" conduct that is, on balance, pro-competitive.<sup>106</sup> The key question, then, is whether the losses from the rule's relative under-deterrence are outweighed by the benefits the rule offers in terms of lower administrative costs and reduced losses from the over-deterrence of pro-competitive conduct. While a detailed accounting of those various costs and benefits is beyond the scope of this Article, there are sound reasons for believing that the losses from the rule's under-deterrence will be outweighed by gains from lower administrative costs and reduced over-deterrence.<sup>107</sup>

<sup>104</sup>See *infra* notes 108–15 and accompanying text.

<sup>105</sup>See *infra* notes 116–29 and accompanying text.

<sup>106</sup>"Mixed bag" conduct refers to practices that may create some market power (and may thus pose anticompetitive risks) but may also create efficiencies (and may thus confer procompetitive benefits). Evaluating mixed bag, single-firm conduct is, of course, the purpose of a generalized test for exclusionary conduct under Sherman Act Section 2.

<sup>107</sup>See *infra* notes 129–50 and accompanying text.

A. *The Equally Efficient Rival Approach's Under-Deterrence*

The equally efficient rival rule is almost certainly somewhat under-deterrent.<sup>108</sup> Critics of the rule point to three sources of under-deterrence. While one of those sources is probably illusory, the other two seem genuine.

First, critics of the rule maintain that it under-deters because it would approve exclusion-causing conduct of no social utility as long as that conduct could not exclude an equally efficient rival.<sup>109</sup> Professor Hovenkamp, for example, offers the example of a fraudulent patent suit that could be successfully defended by a rival with equivalent efficiencies (and thus equivalent per unit profits) but not by a less efficient upstart. Because the filing of such a lawsuit would create no social value and could exclude some competition, the law should sanction such behavior regardless of whether it could exclude an equally efficient rival.<sup>110</sup>

While that point seems correct, it does not discredit the equally efficient rival test. A general test for exclusionary conduct is needed only for evaluating mixed bag conduct that creates some efficiencies but also may enhance market power. "Naked" exclusionary practices—those that exclude competition without providing any efficiency benefits—can be easily condemned without reference to any test for exclusionary conduct. Thus, the fact that the equally efficient rival test would not condemn some instances of naked exclusion is not troubling.<sup>111</sup>

The other two criticisms of the equally efficient rival test are more potent. First, critics have observed that some acts of exclusion can

<sup>108</sup> See generally Lao, *supra* note 18, at 446–47; Hovenkamp, *supra* note 37, at 153–54; Salop, *supra* note 24, at 328–29; Melamed, *supra* note 31, at 388–89; Hovenkamp, *supra* note 11, at 153–55.

<sup>109</sup> See, e.g., Lao, *supra* note 18, at 447 (noting that under the rule "[a] dominant firm would be free to use *any* conduct, including those of no social utility, to exclude the only competitors that it would likely ever face"); Hovenkamp, *supra* note 37, at 154 (arguing that there is value in prohibiting socially useless conduct that could exclude less efficient rivals even if it could not exclude an equally efficient rival).

<sup>110</sup> Hovenkamp, *supra* note 11, at 154.

<sup>111</sup> Cf. Melamed, *supra* note 31, at 399 (observing that "conduct [that] has no efficiency properties and serves only to harm rivals . . . can be readily condemned without application of either a balancing test or a sacrifice test," for such conduct "does not raise the issue at which these tests are directed: what to do about conduct that both has efficiency benefits and excludes rivals").

prevent rivals from attaining equivalent efficiencies.<sup>112</sup> For example, conduct that forecloses marketing opportunities and thus impedes a rival's growth may prevent that rival from achieving minimum efficient scale so that it never becomes as efficient as the perpetrator.<sup>113</sup> The equally efficient rival test under-deters in that it would sanction this sort of efficiency-precluding conduct. In addition, critics of the test assert, there is significant social value in protecting even those rivals who are not as efficient as the perpetrator if they are the only ones likely to arrive on the scene.<sup>114</sup> For example, suppose a dominant firm had costs of \$10 per unit but charged a profit-maximizing price of \$20. The existence or potential entry of a rival with costs of, say, \$13 could be beneficial for consumers. If that rival were to charge \$15 per unit, the dominant firm would be forced to reduce its price or improve its quality.<sup>115</sup> Thus, consumer welfare may be harmed by an exclusionary conduct test that protects only equally or more efficient rivals.

#### *B. The Other Approaches' Over-Deterrence*

While the equally efficient rival test may fail to condemn some instances of anti-competitive unilateral conduct, the competing tests for exclusionary conduct are likely to over-deter if applied *ex post* in the context of litigation. Each of the competing tests requires a

<sup>112</sup>See, e.g., Lao, *supra* note 18, at 447 (“[E]xclusionary practices are often designed specifically to prevent a challenger from gaining scale efficiencies.”); Melamed, *supra* note 31, at 388 (“[A] rival that is less efficient today might become equally or more efficient if permitted time to develop learning-by-doing economies or if its sales grew and enabled it to gain scale economies.”).

<sup>113</sup>See, e.g., Einer Elhauge, *The Exclusion of Competition for Hospital Sales Through Group Purchasing Organizations* 24 n.68, 33–34 (2002) (report to U.S. Senate), available at [http://www.law.harvard.edu/faculty/elhauge/pdf/gpo\\_report\\_june\\_02.pdf](http://www.law.harvard.edu/faculty/elhauge/pdf/gpo_report_june_02.pdf) (arguing that it is not sufficient to ask whether a bundled discount could exclude an equally efficient competitor, for such discounts may be used to prevent rivals from growing and thereby attaining scale efficiencies).

<sup>114</sup>Lao, *supra* note 18, at 447 (“The existence, or even the potential entry, of a less efficient rival can, in fact, constrain a monopolist, thereby benefiting consumers, and its exclusion would harm consumer welfare.”); Salop, *supra* note 24, at 328–29 (noting that “unencumbered (potential) entry of less-efficient competitors often raises consumer welfare”); Hovenkamp, *supra* note 11, at 154 (noting that equally efficient rival test “can underdeter in situations where the rival that is most likely to emerge is less efficient than the dominant firm”).

<sup>115</sup>Lao, *supra* note 18, at 447; see also Salop, *supra* note 24, at 328–29 (offering similar example).



detailed factual inquiry that would likely have to be resolved at trial by a finder of fact—usually a jury. That is troubling, because antitrust issues are notoriously difficult for juries to comprehend,<sup>116</sup> and the risk of an arbitrary damages award—automatically trebled<sup>117</sup>—is quite significant. Business firms, recognizing this risk, may forego conduct that is pro-competitive on the whole but might not be recognized as such by a bunch of overwhelmed jurors.<sup>118</sup>

First consider the consumer welfare effect test set forth in the Areeda-Hovenkamp treatise.<sup>119</sup> That test deems conduct exclusionary if it is “reasonably capable of creating, enlarging or prolonging monopoly power by impairing the opportunities of rivals” and either does not benefit consumers at all or is not necessary for the claimed consumer benefits or produces harms disproportionate to the benefits produced.<sup>120</sup> Under that test, practically all mixed bag conduct would have to be evaluated by a jury. A court could grant summary judgment only if the conduct at issue was not “reasonably capable of creating, enlarging or prolonging monopoly power by impairing the opportunities of rivals” (in which case the defendant would be entitled to summary judgment) or if the conduct caused exclusion

<sup>116</sup>Consider, for example, Professor Arthur Austin’s account of his post-trial interviews of the *Brooke Group* jurors. Austin concluded that “the jurors were overwhelmed, frustrated, and confused by testimony well beyond their comprehension” and that “at no time did any juror grasp—even at the margins—the law, the economics or any other testimony relating to the allegations or defense.” Arthur Austin, *The Jury System at Risk from Complexity, the New Media, and Deviancy*, 73 *Denv. U. L. Rev.* 51 (1995).

<sup>117</sup>See 15 U.S.C. § 15 (providing for automatic trebling of damages in most civil antitrust suits).

<sup>118</sup>Professor Elhauge, for example, observes that firms must operate under the risk that the actual criteria by which their conduct will be judged will depend largely on the happenstance of which judge and jurors will be selected in a trial a great number of years later that will retroactively decide whether to assess multimillion or even multibillion dollar treble damages. Further, firms run the risk that different judges or juries will reach inconsistent conclusions about the legality of their conduct based on different implicit normative criteria. These sorts of risks cannot help but chill investments to create product offerings with a sufficient quality or cost advantage over preexisting market options. . . .

Elhauge, *supra* note 15, at 266–67.

<sup>119</sup>3 Areeda & Hovenkamp, *supra* note 30, ¶ 651a at 72 (discussed *supra* in notes 30–34 and accompanying text).

<sup>120</sup>See *Id.*

but created no consumer benefit (in which case the plaintiff would be entitled to summary judgment on the exclusionary conduct element). All other cases would raise fact issues regarding the necessity of the conduct for the claimed consumer benefit and the degree to which the benefits of the conduct exceeded the costs thereof.<sup>121</sup> Given the prospects of an adverse verdict awarding treble damages, firms would do well to avoid any conduct—even efficiency-enhancing conduct—that could impair rivals’ opportunities and thereby create, enlarge, or prolong monopoly or monopsony power.

On first glance, the sacrifice-based tests would seem to avoid this problem, for they call for a much more focused inquiry and create an apparent safe harbor for conduct that would enhance profits apart from an increase in market power. In actual practice, however, the sacrifice-based tests are likely to be similarly indeterminate and thus susceptible to arbitrary jury verdicts and the over-deterrence they generate. To apply the profit sacrifice or no economic sense test, a court would compare the defendant’s expected profits without the allegedly exclusionary practice to what its profits would have been with the practice if there were no price-raising (or input cost-lowering) resulting from enhanced monopoly (or monopsony) power.<sup>122</sup> This gets quite complicated when the conduct at issue is likely to result in some efficiency enhancements and some increase in market power.<sup>123</sup> Because the key question is whether the conduct would be profitable but for the enhancement of market power, the fact-finder must: (1) determine the cost to the defendant of engaging in the conduct at issue, (2) ascertain the incremental revenue gain resulting from the conduct at issue, (3) estimate the portion of that revenue gain attributable to an increase in market power, (4) subtract

<sup>121</sup>In *Weyerhaeuser*, for example, plaintiff Ross-Simmons could easily have shown that defendant Weyerhaeuser’s overbidding was reasonably capable of creating or enlarging monopsony power, see *supra* note 89 and accompanying text, so the case would have had to go to a jury to determine whether the conduct produced harms disproportionate to any consumer benefits.

<sup>122</sup>Salop, *supra* note 24, at 319 (discussing implementation of profit sacrifice test and its no economic sense variant).

<sup>123</sup>Indeed, Gregory Werden, an advocate of the no economic sense version of the test, admits as much. Werden, *supra* note 33, at 415–16 (“The application of the test can be difficult . . . if the defendant benefits from the conduct absent any tendency to eliminate competition, because the test may then require an analysis of a competitive environment quite different from that which currently exists.”).

that amount from the total incremental revenue gain, and (5) compare the remaining incremental revenue gain to the cost of engaging in the conduct at issue. Only if the nonmarket power-induced revenue enhancement exceeds the cost of engaging in the conduct is such conduct non-exclusionary.<sup>124</sup>

An approach that asked whether challenged conduct raised rivals' costs unjustifiably would almost always send challenged conduct to the jury for an open-ended, unpredictable evaluation. If justifiability were assessed on a case-by-case basis, jurors would be called on to conduct a highly indeterminate "totality of the circumstances" inquiry. Even under the more structured approach advocated by Professor Elhauge, who has acknowledged the need to provide determinate standards,<sup>125</sup> arbitrary jury decisions would be inevitable. Elhauge defines "justifiable" cost-raising as that which occurs because of an enhancement in the defendant's efficiency; cost-raising occurring *regardless* of an increase in the defendant's efficiency is *per se* unjustifiable.<sup>126</sup> On first glance, the fact-finder's task appears simple: determine whether the increase in rivals' costs is a byproduct of an enhancement in the defendant's efficiency.<sup>127</sup> In actual practice, though, that inquiry gets quite messy.

Consider, for example, a challenge to a firm's 12% loyalty rebate on purchases over 1,000 units. Suppose that a rival firm claimed that this structured discount usurped so much business from the rival that it fell below minimum efficient scale (i.e., its per-unit costs were raised). The jury, then, would have to determine whether that cost-raising was justifiable. Suppose that the defendant demonstrated that it was running its factories at 70% capacity prior to

<sup>124</sup>In *Weyerhaeuser*, for example, the fact-finder would have had to (1) determine what it cost Weyerhaeuser to overbid, (2) predict how much Weyerhaeuser's total revenues were expected to increase because of the overbidding, (3) figure what percentage of that expected increase would be due to monopsony power, and (4) compare the remaining expected revenue enhancement to the cost of the overbidding to determine whether the overbidding would have made economic sense but for the enhancement in monopsony power.

<sup>125</sup>See *supra* note 118.

<sup>126</sup>See *supra* note 27.

<sup>127</sup>Elhauge, *supra* note 15, at 256 (arguing that the only tolerable conduct that raises rivals' costs is that which "successfully impair[s] rival efficiency only as a byproduct of the defendant improving its own efficiency").

offering the discount and that the discount increased sales so that the factories were run at 90% capacity, creating apparent economies of scale. If the plaintiff could show (1) that all available efficiencies could be exploited at 80% capacity because incremental scale economies above that level of production were offset by diseconomies occasioned by excessive wear and tear, and (2) that an 8% loyalty rebate would drive production to 80% capacity, then the “excessive” loyalty discount (the additional four percentage points) would appear unjustifiable—i.e., it would raise rivals’ costs “regardless of any improvement in defendant efficiency.”<sup>128</sup> Of course, it would be a Herculean task to determine the level of production at which economies of scale are maximized and the size of any structured discount necessary to achieve that level. But that is precisely the task a jury would confront under a raising rivals’ cost test. Arbitrary verdicts—and the chilling effect they inspire—would inevitably result.

*C. Why the Equally Efficient Rival’s Under-Deterrence Is of Less Concern than Other Approaches’ Over-Deterrence*

We have seen that a liability rule requiring a plaintiff to establish exclusion of an equally efficient rival is somewhat under-deterrent but that the other proposed tests for exclusionary conduct are likely to over-deter. The key question, then, is whether the social loss resulting from the equally efficient rival test’s under-deterrence is likely to outweigh that stemming from the other tests’ over-deterrence, or vice-versa. While a detailed accounting of the welfare losses occasioned by the various tests is beyond the scope of this article, there are good reasons to suspect that the equally efficient rival test’s under-deterrence is the better poison.

As noted above, the equally efficient rival test may produce false negatives for two reasons: it does not condemn practices that prevent rivals from becoming as efficient as the defendant, and it may permit exclusion of the only competition a dominant firm is likely to face if that competition is less efficient than the dominant firm.<sup>129</sup> The

<sup>128</sup> Elhaug, *supra* note 15, at 330.

<sup>129</sup> See *supra* notes 108–14 and accompanying text. (As noted, it is of no concern that the equally efficient rival test could approve socially useless conduct that would exclude less efficient rivals. A generalized test for exclusionary conduct is needed only when the challenged conduct presents a “mixed bag” of pro-competitive benefits and anti-competitive harms. See *supra* note 111 and accompanying text.)

first concern is not that great, for a broader definition of exclusionary conduct under Section 2—a definition that would capture conduct that could prevent rivals from achieving equivalent efficiency—would not provide much benefit in terms of *added* deterrence. That is because most of the means by which a defendant might attempt to prevent rivals from attaining equivalent efficiency either (1) are already regulated by another legal provision; (2) would be permitted, regardless of the governing test for exclusionary conduct, by immunities or safe harbors; or (3) could not succeed against a smaller rival that is both aggressive and competent.

To see this point, consider the various means by which a defendant could prevent rivals from achieving equivalent efficiencies. Most obviously, the defendant could engage in practices that would prevent rivals from reaching minimum efficient scale. For example, the defendant could engage in exclusive dealing or tying, both of which have the effect of foreclosing rivals from marketing opportunities.<sup>130</sup> It could also achieve foreclosure by offering discounts that have the effect of usurping business from rivals.<sup>131</sup> Alternatively, it might engage in more direct means of foreclosure by, for example, paying dealers not to carry rivals' products. If the defendant controlled an asset that rivals needed to access in order to grow to minimum efficient scale, it could deny access to that asset.<sup>132</sup>

In addition to denying rivals scale, a defendant might prevent rivals from attaining equivalent efficiency by taking steps to drive up the price of an input. Of course, the defendant would have to ensure that the price of the input rose for rivals only and not for itself; otherwise, the strategy would not render rivals *relatively* inefficient.<sup>133</sup>

<sup>130</sup> See Hovenkamp, *supra* note 37, at 199–201 (explaining how both exclusive dealing and tying, while often procompetitive, can lead to market foreclosure).

<sup>131</sup> *Id.* at 171–74 (explaining how structured discounts such as loyalty or bundled discounts can lead to market foreclosure); *id.* at 161–62 (discussing foreclosure effects of predatory and limit pricing).

<sup>132</sup> See generally Phillip Areeda & Herbert Hovenkamp, 3A Antitrust Law ¶ 772a, at 174 (2d ed. 2002) (explaining “intuitive appeal” of essential facilities doctrine, which may reach either concerted or unilateral refusals to share).

<sup>133</sup> Thus, Weyerhaeuser-type overbidding, which drives up input prices for all competitors, could not preclude rivals from attaining equivalent efficiencies.

The defendant would therefore need to convince input-suppliers to charge a higher price to rivals than to the defendant.<sup>134</sup>

A third means of preventing equivalent efficiencies could be exploited by defendants who sell a product that must be used in conjunction with the competitive product. By redesigning the complementary product so that it would work with the defendant's version of the competitive product but not with that of rivals, the defendant could force rivals to engage in costly product re-design, thereby reducing their efficiencies relative to the defendant's.<sup>135</sup>

Finally, a defendant might render rivals less efficient by convincing the government to impose some restriction that would raise rivals' costs relative to those of the defendant.<sup>136</sup> For example, a defendant might lobby regulators to require all competitors to adopt design specifications the defendant was already utilizing.

While all of these strategies could plausibly prevent less efficient rivals from becoming as efficient as a defendant and therefore would not be condemned as exclusionary under the equally efficient rival test, that possibility does not provide a compelling reason for rejecting the test in Section 2 cases. Expanding Section 2 liability to reach the aforementioned practices would provide little in the way of additional deterrence. First, many of the practices are already adequately regulated. Any exclusionary practice involving concerted conduct—an agreement—is covered by Section 1 of the Sherman Act.<sup>137</sup> Thus, tying, exclusive dealing, concerted refusals to deal,

<sup>134</sup>This would require some sort of agreement between the defendant and input suppliers.

<sup>135</sup>See Phillip E. Areeda, Herbert Hovenkamp & Einer Elhauge, 10 *Antitrust Law* ¶ 1757a, at 317 (2d ed. 2004) (recognizing that "if a defendant has market power in a primary product that works better with his complementary product than with rival versions, this technological interdependence may have the 'practical effect' of foreclosing rivals in the complementary market" and proposing liability in very limited circumstances that would include, *inter alia*, redesign to create incompatibility).

<sup>136</sup>Phillip E. Areeda & Herbert Hovenkamp, 1 *Antitrust Law* ¶ 201, at 145 (2d ed. 2002) ("Collaborators or a single firm might use the machinery of government to obtain, maintain, or strengthen market power. Such a use could thus restrain trade or be an exclusionary practice if the behavior is improper, unlawful, not privileged, appropriate for inquiry by the antitrust court (or agency), and significant in result.").

<sup>137</sup>15 U.S.C. § 1 (prohibiting every "contract, combination . . . , or conspiracy" that unreasonably restrains trade).

agreements with dealers not to carry a rival's products, and agreements with the other owners or controllers of a jointly owned/controlled essential facility—behaviors that could reduce a rival's scale and render it relatively less efficient—are all regulated subject to well-established liability tests implementing Section 1's prohibition of unreasonable restraints of trade. The same would be true for any agreement with input suppliers that caused them to charge a higher price to rivals.

Of the remaining practices that might reduce rivals' efficiencies, many would be permissible—even if they were deemed “exclusionary” under the governing test—by immunities or safe harbors. Most exclusionary practices involving the procurement of government regulations, for example, would be permitted by the Noerr-Pennington doctrine, which removes most governmental petitioning from antitrust scrutiny.<sup>138</sup> Re-design of a complementary product would likely be protected under safe harbors that have been proposed as part of the other tests for exclusionary conduct.<sup>139</sup> And the Supreme Court has recently hinted that there can be no antitrust liability based on denial of access to an essential facility controlled exclusively by the defendant.<sup>140</sup>

The remaining practices on the laundry list of acts that could prevent rivals from attaining efficiencies involve discounting. While below-cost discounting and some above-cost “bundled” discounting would run afoul of the equally efficient rival test,<sup>141</sup> even some above-cost, single product discounting may prevent rivals from attaining

<sup>138</sup>See generally 1 Areeda & Hovenkamp, *supra* note 136, at ¶¶ 200–12 (summarizing Noerr-Pennington petitioning immunity and its “sham” exception).

<sup>139</sup>See, e.g., Werden, *supra* note 33, at 419 (proposing that no economic sense test include a safe harbor for new product introduction, improved product quality, and cost-reducing innovations because “the tools of antitrust are too blunt to make it worthwhile to attempt to the identification of rare exceptions” to the general rule that such conduct benefits consumers); 3 Areeda & Hovenkamp, *supra* note 30, ¶ 651b, (proposing that consumer welfare effect test include a safe harbor for “improved product quality, energetic market penetration, successful research and development, cost-reducing innovations, and the like”).

<sup>140</sup>See *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 410–11 & n.3 (2004) (declining to recognize or repudiate an “essential facilities” doctrine in case involving unilateral denial of access and taking pains to distinguish cases imposing liability for concerted denial of access).

<sup>141</sup>To compete with a defendant's below-cost price, a rival with equivalent efficiencies would have to price below its own costs. If it lacked the financial reserves to weather such a money-losing strategy, it could be driven out of business. With respect

equivalent efficiencies. For example, commentators have argued that so-called “limit pricing” (discounting from the profit-maximizing price level to a level that is below competitors’ costs but still above one’s own costs) and above-cost “loyalty discounts” (discounts or rebates that are conditioned upon meeting a certain purchase target) may be used to prevent rivals from growing to minimum efficient scale and thereby attaining equivalent efficiencies.<sup>142</sup> It seems, though, that an aggressive and competent rival confronting these sorts of practices would not be prevented from attaining equivalent efficiencies. If the disadvantaged rival’s product was as good as the discounter’s and could be produced as cheaply at minimum efficient scale, the rival should be able to raise enough capital to fund any discount necessary to grow its market share to the point necessary to achieve minimum efficient scale.<sup>143</sup> Its below-cost pricing for the period required to achieve such a scale would not amount to predation because there would be no likelihood of recoupment via supra-competitive pricing.<sup>144</sup>

It seems, then, that most of the practices that would prevent rivals from achieving minimum efficient scale are either regulated by other

to “bundled” discounts (i.e., discounts conditioned upon purchasing products from multiple product markets), even some discounts that are above-cost—in that the discounted price exceeds the aggregate cost of the products in the bundle—may exclude equally efficient competitors that do not produce as broad a line of products. See Thomas A. Lambert, *Evaluating Bundled Discounts*, 89 Minn. L. Rev. 1688, 1695–97 (2005). (explaining how bundled discount could exclude equally efficient, but less diversified, rival).

<sup>142</sup>Hovenkamp, *supra* note 37, at 162 (limit pricing); Tom et al., *supra* note 26, at 627–29 (loyalty discounts).

<sup>143</sup>See Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 421b, at 67 (2d ed. 2002) (“If capital markets are working well, new investment will be made in any market earning anything above competitive returns—a term defined to include sufficient profit to attract new capital—regardless of the absolute cost of entry.”); George J. Stigler, *The Organization of Industry* 67–69 (1968); Harold Demsetz, *Barriers to Entry*, 72 Am. Econ. Rev. 47, 49–53 (1982); Harold Demsetz, *Industry Structure, Market Rivalry, and Public Policy*, 16 J. L. & Econ. 1, 4 (1973). But see Richard R. Nelson, *Comments on a Paper by Posner*, 127 U. Pa. L. Rev. 949, 950 (1979) (“The Chicago proposition that scale economies don’t serve as a barrier to entry hinges on explicit or implicit assumptions about perfect capital markets and no adjustment lags or costs.”).

<sup>144</sup>See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222–24 (1993) (positing the likelihood of recoupment via future monopoly pricing as prerequisite to a valid predation claim).



prohibitions besides Section 2, or subject to immunities or safe harbors that would prevent condemnation under Section 2, or unlikely to succeed against aggressive and competent rivals. Accordingly, the first source of the equally efficient rival test's under-deterrence is of little concern.

That leaves the second source of under-deterrence and raises the following question: In order to preserve rivals that are less efficient than the dominant firm but may constrain its exercise of market power, does it make sense to adopt a broader definition of exclusionary conduct under Section 2? Probably not. Monopoly profits provide a powerful incentive to enter monopolized markets, and it is quite difficult for monopolists to continually fight off new entrants.<sup>145</sup> For that reason, there are very few "real" monopolies—i.e., markets in which a single seller faces no meaningful competition. By contrast, mixed bag business practices that are pro-competitive on the whole are ubiquitous and are conceived of all the time. A broader, harder to apply test for exclusionary conduct would stymie those efficiency-enhancing practices, and since they are far more common than unchecked monopolies, it is more important to avoid thwarting them than to insure against the uncommon and unstable case of unchecked monopoly.<sup>146</sup>

In addition, a somewhat under-deterrent definition for exclusionary conduct is appropriate because significant over-deterrence is already built into Section 2. Successful antitrust plaintiffs are generally entitled to treble damages.<sup>147</sup> This damages multiplier, designed to account for the chance that a violation may go undetected or may

<sup>145</sup> Frank H. Easterbrook, *The Limits of Antitrust*, 63 *Tex. L. Rev.* 1, 2 (1984).

<sup>146</sup> As Judge Easterbrook has explained, the harms related to false positives and false negatives are incommensurate:

If the court errs by condemning a beneficial practice, the benefits may be lost for good. Any other firm that uses the condemned practice faces sanctions in the name of *stare decisis*, no matter the benefits. If the court errs by permitting a deleterious practice, though, the welfare loss decreases over time. Monopoly is self-destructive. Monopoly prices eventually attract entry. True, this long run may be a long time coming, with loss to society in the interim. The central purpose of antitrust is to speed up the arrival of the long run. But this should not obscure the point: judicial errors that tolerate baleful practices are self-correcting while erroneous condemnations are not.

*Id.* at 2–3.

<sup>147</sup> 15 U.S.C. § 15.

not be successfully prosecuted, makes sense for clandestine practices that are unquestionably bad, such as price-fixing conspiracies. Trebling seems inappropriate, though, when the challenged conduct is a mixed bag practice that is conducted out in the open.<sup>148</sup> Awarding treble damages to plaintiffs who successfully challenge such conduct will invite lawsuits of little merit (it's easy to bring the lawsuit, and the payoff could be huge) and will thus tend to deter candid business practices that are pro-competitive on the whole but difficult to characterize and might, if challenged, be deemed to violate some provision of the antitrust laws.<sup>149</sup> The practices to be evaluated under a generalized definition of exclusionary conduct are precisely the sorts of practices for which trebling is overly deterrent: they are mixed bag practices and they are conducted unilaterally (so they do not involve secret collusion). For that reason, a somewhat under-deterrent liability standard may function as a salutary corrective.

*D. Some Examples: Loyalty and Bundled Discounts*

Brief consideration of two business practices that have recently been challenged as exclusionary demonstrates the superiority of the equally efficient rival test in Section 2 cases. Both loyalty discounts and bundled discounts<sup>150</sup> offer some pro-competitive benefits (most obviously, consumer-friendly price competition) but may tend to exclude rivals from the discounter's market.<sup>151</sup> They are precisely the sort of mixed bag, unilateral practice for which a general exclusionary conduct test is useful. It is thus helpful to compare how challenges to the practices would proceed under the various approaches.

Under each of the rejected approaches, challenges to either practice would almost automatically require jury consideration. Under sacrifice-based tests, the jury would have to determine whether some

<sup>148</sup>See Hovenkamp, *supra* note 37, at 66–68; Posner, *supra* note 19, at 271–73.

<sup>149</sup>Hovenkamp, *supra* note 37, at 67.

<sup>150</sup>Loyalty discounts are discounts or rebates on all purchases of some product once the purchaser meets a certain purchase target, such as  $x$  percent of its requirements. Bundled discounts are discounts or rebates conditioned on purchasing multiple goods from different product markets. See Lambert, *supra* note 144, at 1693–95, 1706–08 (describing bundled and loyalty, or “single-product purchase target,” discounts).

<sup>151</sup>*Id.* at 1706–07 (explaining how loyalty rebates could exclude); *Id.* at 1695–97 (explaining how bundled discounts could exclude).

increment of the discount or rebate made no economic sense but for its ability to exclude rivals. (For example, if the discount were 10%, would the discounter, absent an exercise of market power, have been better off offering a 7% discount? If so, the incremental three percentage points of discount would make no economic sense but for the market power it created and would thus be exclusionary.) The consumer welfare effect test would require the jury to balance the consumer benefits of the discount against the consumer harms that could result if the discount impaired rivals and enhanced the discounter's market power. Raising rivals' costs approaches would require the jury to determine whether any impairment of rivals' efficiencies resulting from reduced scale was justified. Under Professor Elhauge's test for justifiability, the jury would have to determine whether the discount was greater than necessary to achieve whatever productive or distributional efficiencies it created; if so, the excess discount would raise rivals costs "regardless of any improvement in defendant efficiency" and would thus be unreasonably exclusionary.<sup>152</sup> Given the near inevitability that a challenge to loyalty or bundled discounting would result in jury consideration and a potential adverse treble damages verdict under these three approaches, the approaches would likely deter many consumer-friendly discounts. Indeed, two decisions that gave juries great leeway to evaluate the legality of structured discounts—the district court decision in *Concord Boat*<sup>153</sup> and the en banc Third Circuit decision in *LePage's*<sup>154</sup>—created significant concern for firms contemplating such discounts.<sup>155</sup>

By contrast, if loyalty or bundled discounts were evaluated under the equally efficient rival test, firms considering such discount programs could rely on genuine safe harbors. With respect to loyalty

<sup>152</sup> Elhauge, *supra* note 15, at 330.

<sup>153</sup> *Concord Boat Corp. v. Brunswick Corp.*, 21 F. Supp. 2d 923, 929–30 (E.D. Ark. 1998) (denying defendant's motion for judgment as a matter of law in case involving above-cost loyalty discounts), *rev'd* 207 F.3d 1039 (8th Cir. 2000).

<sup>154</sup> *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (en banc) (upholding jury verdict imposing Section 2 liability based on above-cost bundled discounts), *cert. denied*, 542 U.S. 953 (2004).

<sup>155</sup> Cf. Antitrust Modernization Commission, Report and Recommendations 94 (2007), available at [http://www.amc.gov/report\\_recommendation/amc\\_final\\_report.pdf](http://www.amc.gov/report_recommendation/amc_final_report.pdf) ("[T]he Third Circuit's [LePage's] decision is likely to discourage firms from offering procompetitive bundled discounts and rebates to consumers.').

discounts, firms would not need to worry about any discount that resulted in a discounted price that was still above the discounter's cost; any such discount could be met by, and thus would not exclude, an equally efficient rival.<sup>156</sup> Bundled discounts are a different competitive animal, for they may drive equally efficient rivals from the market even if they result in an above-cost price for the collection of items in the bundle.<sup>157</sup> Still, if such discounts were evaluated under the equally efficient rival test for exclusionary conduct, genuine safe harbors would exist. I have elsewhere detailed one safe harbor—i.e., a set of circumstances in which no equally efficient rival would be excluded by a bundled discount.<sup>158</sup> In addition, the *Ortho* court, implicitly relying on the equally efficient rival approach to identifying exclusionary conduct, created a safe harbor for bundled discounts by requiring that plaintiffs challenging such discounts prove either that the discounts resulted in a below-cost price for the bundle or that they were as efficient as the discounter but were not able to compete because of the discount.<sup>159</sup> Under that rule, a firm that knew it was the most efficient competitor could offer bundled discounts without fear of liability. Thus, the equally efficient rival test creates clear safe harbors. In light of the realities of antitrust litigation and the limited abilities of juries to resolve complicated economic questions, the test is therefore less likely than the rejected approaches to deter above-cost loyalty and bundled discounts, as well as other mixed bag practices that are pro-competitive on the whole but that might be deemed exclusionary by perplexed jurors.

## V. Conclusion

Just last year, Professor Steven Salop curtly dismissed “the *Brooke Group* standard,” which ultimately focuses on whether the conduct at issue could exclude an equally efficient rival, by observing that

<sup>156</sup>In reversing the district court and holding that the *Concord Boat* defendant's conduct could not give rise to antitrust liability absent proof that the discount resulted in below-cost pricing, the Eighth Circuit created this sort of safe harbor for above-cost loyalty discounts. See *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1061–63 (8th Cir. 2000).

<sup>157</sup>See Lambert, *supra* note 141, at 1695–96.

<sup>158</sup>See *id.* at 1742–53.

<sup>159</sup>*Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 469 (S.D.N.Y. 1996) (setting forth test for evaluating legality of bundled discount).

it “is not generally proposed as the liability standard for exclusionary conduct other than predatory pricing.”<sup>160</sup> After *Weyerhaeuser*, the equally efficient rival standard cannot be so limited. Indeed, the other proposed definitions of exclusionary conduct would have mandated a different outcome in *Weyerhaeuser*, and the Supreme Court thus appears to have implicitly rejected those standards in favor of the equally efficient rival standard.

In doing so, the Court adhered to Voltaire’s prudent maxim, “The perfect is the enemy of the good.”<sup>161</sup> The equally efficient rival standard, while good, is admittedly imperfect: it is under-deterrent. On the other hand, its more “perfect” competitors—those that would more exhaustively condemn practices that could be anti-competitive in the long run—would entail administrative difficulties that would almost certainly result in the over-deterrence of practices that are, on the whole, pro-competitive. Because the welfare loss from such over-deterrence would likely outweigh that occasioned by the equally efficient rival test’s under-deterrence, the *Weyerhaeuser* Court was wise to forego the perfect in favor of the good.

<sup>160</sup>Salop, *supra* note 24, at 318.

<sup>161</sup>Le mieux est ennemi du bien, Voltaire, *La Begueule*, 3 Recueil des Meilleurs Contes en vers 77, 77 (1778).

