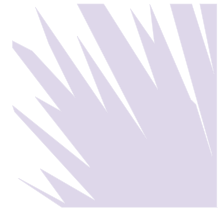


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PREDATORY CONDUCT UNDER SECTION TWO OF THE SHERMAN ACT: DEAD OR ALIVE?

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Predatory conduct by firms with market power has been the subject of recent major litigation both by the government and private parties, and has also been the subject of new economic scholarship in recent years. The ultimate result of this litigation and scholarship in terms of marking new boundaries for the conduct of firms with market power is still unclear. What has become clear, however, is that antitrust practitioners, and corporate counsel, must carefully weigh the antitrust risks entailed by business strategies designed to entrench and exploit market power. Although the most well-known example of such conduct is the *Microsoft* case, there are many other cases which raise similar issues.¹

In the interest of candor, I must confess at the outset that I cannot claim perfect objectivity on the subject of predatory conduct under Section 2. I never was much of a fan of the Chicago School's view that "the market will fix all things." And as one of the few lawyers to actually try a major Section 2 case using some of the emerging economic theories, in a case discussed below, I have seen the real world anticompetitive effects of successful predation.

HISTORIC OVERVIEW - SHERMAN SECTION 2 PREDATION

Predatory conduct under Section 2 has most recently generally been thought of in terms of predatory pricing. Indeed, for much of the last 25 years predatory pricing as a basis for Section 2 claims has been a focus of scholars and the Courts. Thanks to some highly visible cases such as *Matsushita*² and *Brooke Group*,³ unfortunately all that most lawyers and judges know about Section 2 predation is that for pricing to be "predatory" the prices must be "below the appropriate measure of cost"⁴ and that "predatory pricing schemes are rarely tried, and even more rarely successful."⁵

However, there is a long and rich history of cases under Section 2 that involve conduct other than below-cost pricing which we would now label "predatory." These cases establish antitrust principles which support the emerging theories of predation. The following are a few examples of such cases and principles.

One of the earliest cases is *United States v. Terminal R.R. Assoc.*, 224 U.S. 383 (1912). Although most commonly cited as a refusal to deal and/or essential facilities case, this famous case is really an example of raising rivals' costs and erecting entry barriers. The

¹ This paper was submitted for publication shortly after the decision of the Court of Appeals for the District of Columbia issued its opinion in *United States, et al. v. Microsoft ("Microsoft III")*, ___ F.3d ___, D.C. Cir. 2001, 2001 WL 721343.

² *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

³ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

⁴ *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 117 (1986).

⁵ *Matsushita*, 475 U.S. at 589.

facts of the case are familiar to most antitrust lawyers. The infamous Jay Gould organized the St. Louis Terminal Association, a group of six railroad companies, which obtained control over all of the bridges over the Mississippi River connecting East St. Louis to St. Louis, and all related terminal facilities. The Terminal Association refused to permit other railroad companies to use the bridges or terminal facilities. The result was a huge entry barrier, for any other railroad company would not only have had to erect a bridge across the Mississippi, but would have to replicate existing terminal facilities. The Supreme Court properly held that the conduct was “an obstacle, a hindrance, and a restriction upon interstate commerce” *id.* at 514, and therefore violated Sections 1 and 2 of the Sherman Act.

Another early case is *United Shoe Machinery Corp., et al. v. United States*, 258 U.S. 451 (1922). Although the action was brought under the exclusive dealing provisions of Section 3 of the Clayton Act, the principles of *United Shoe* have been applied in the context of similar claims brought under Section 2. In this case the United States challenged the machinery-leasing practices of the United Shoe Machinery Corp., which the Court found enjoyed “a dominant position in the production of [shoe making] machinery.” *Id.* at 455. The Court upheld a district court order enjoining the use of a combination of lease terms which had the effect of preventing lessors from also leasing the shoe-making machinery of United’s competitors. In language which continues to be relevant to modern predation analysis the Court stated:

While the clauses enjoined do not contain specific agreements not to use the machinery of a competitor of the lessor, the practical effect of these drastic provisions is to prevent such use. We can entertain no doubt that such provisions as were enjoined are embraced in the broad terms of the Clayton Act, which cover all conditions, agreements, or understandings of this nature. That such restrictive and tying agreements must necessarily lessen competition and tend to monopoly is, we believe, equally apparent. When it is considered that the United Company occupies a dominating position in supplying shoe machinery of the classes involved, these covenants, signed by the lessee and binding upon him, effectually prevent him from acquiring the machinery of a competitor of the lessor, except at the risk of forfeiting the right to sue the machines furnished by the United Company, which may be absolutely essential to the prosecution and success of his business.

This system of “tying” restrictions is quite as effective as express covenants could be, and practically compels the use of the machinery of the lessor, except upon risks which manufacturers will not willingly incur. It is true that the record discloses that in many instances these provisions were not enforced. In some cases they were. In frequent instances it was sufficient to call the attention of the lessee to the fact that they were contained in the lease to insure a compliance with their provisions. The power to enforce them is omnipresent, and their restraining influence constantly operates upon competitors and lessees. The fact that the lessor in many instances forbore to enforce these provisions does not make them any less agreements within the condemnation of the Clayton Act.

Id. at 457-58.

Interestingly, among the lease provisions found to be anticompetitive was a term called the “factory output clause” which the Court described as requiring “the payment of a royalty on shoes operated upon by machines made by competitors.” *Id.* at 457. The

operation of such a provision is remarkably similar to the Microsoft “per processor license” which the United States challenged in *Microsoft I* 70 years later, which is discussed below.

In another early case, *Carter Carburetor v. Federal Trade Comm’n*, 112 F.3d 722 (8th Cir. 1940) the Eighth Circuit applied the rationale of *United Shoe* in upholding the findings and conclusions of the F.T.C. that Carter Carburetor Corp., the dominant manufacturer of carburetors for the automobile industry, had violated Section 3 of the Clayton Act and, implicitly, Section 2 of the Sherman Act,⁶ by tying its most favorable discounts to service stations’ agreement not to take on new lines of competing carburetors. *Id.* at 732. The Court stated:

It was made perfectly clear to all service stations that their preferential discount would be available only on condition that they did not carry or take on a new competing line. Under these circumstances it is immaterial that those who handled petitioner’s products were not obliged to affirmatively promise in express terms not to handle goods of Carter’s competitors. The condition against handling the goods of competitors was made as fully effective as though it had been written in and affirmatively agreed to in the express terms in the contract.

It follows the practices of a dominant carburetor manufacturer which are designed to and do prevent a new manufacturer from obtaining a foothold in the service field will handicap the new manufacturer in selling his carburetors for original equipment and may prevent him from marketing a superior product at an equal or lower price. The petitioner’s restraint upon competition works in a vicious circle, since service sales on any carburetor normally depend on the number of automobiles equipped with the carburetor, and loss of service sales and distribution by the carburetor manufacturer in turn affects his ability to meet price competition and service requirements in offering his product for original equipment.

Id. at 733.⁷

In *Federal Trade Comm’n v. Brown Shoe Company*, 384 U.S. 316 (1966), another predatory exclusion case, the Supreme Court held that economic incentives toward exclusive dealing could, in appropriate circumstances, be anticompetitive. In that case the Court considered Brown Shoe’s practice of entering into franchise agreements with retail shoe stores which limited the stores’ ability to sell competing lines of shoes. The Court stated:

Thus, the question we have for decision is whether the Federal Trade Commission can declare it to be an unfair practice for Brown, the second largest manufacturer of shoes in the Nation, to pay a valuable consideration to hundreds of retail shoe purchasers in order to secure a contractual promise from them that they will deal primarily with Brown and will not purchase conflicting lines of shoes from Brown’s competitors.

Id. at 320. The Court noted that the Commission’s trial examiner had found that Brown’s contracts “effectively foreclosed Brown’s competitors from selling to a substantial number of retail shoe dealers.” *Id.* at 314. The Court found that Brown’s contracts “conflict with the basic policies of the Sherman and Clayton Acts” *Id.* at 321.

⁶ The Commission and the Eighth Circuit found that the “action of petitioner also tends to create a monopoly.” 112 F.2d at 733.

⁷ See also, *Standard Oil Co. v. United States*, 337 U.S. 293 (1949); Krattenmaker, Lande & Salop, *Monopoly Power and Market Power in Antitrust Law*, 76 Geo. L.J. 241 (1987).

In *Aspen Highland Skiing Corp. v. Aspen Skiing Corp.*,⁸ the defendant, a ski resort operator who owned three of the four ski mountains in Vail, Colorado, discontinued a joint marketing arrangement with the plaintiff, its much smaller and only competitor. The Supreme Court held the defendant could not discontinue the cooperative lift arrangement, particularly since it could show no legitimate reason for its actions apart from putting its only rival out of business. In so holding, the Court provided the following definition for “exclusionary conduct”:

If a firm has been “attempting to exclude rivals on some basis other than efficiency,” it is fair to characterize its behavior as predatory.⁹

Finding that the defendant’s conduct was “predatory” with no valid business justification, the Court held that where the defendant has substantial market power, its refusal to continue doing business with its competitor, in the absence of any legitimate business justification, constituted exclusionary conduct and a violation of Sherman Section 2.¹⁰ Nothing in the opinion (or in the Court’s definition of exclusionary conduct under Sherman Section 2) requires a showing of predatory prices or, for that matter, anything to do with pricing whatsoever.

The Court again found that conduct not involving predatory pricing could constitute a Sherman Section 2 violation in *Eastman Kodak Co. v. Image Tech. Serv., Inc.*¹¹ There, the Court reviewed a suit by independent service organizations (“ISOs”), third-party servicers of Kodak photocopiers. In the past, Kodak supported these businesses, providing supplies and technical information to them. Kodak then changed its policy and stopped distributing the supplies and information. The ISOs argued that Kodak’s photocopier patents effectively prevented third parties from servicing the machines, and that Kodak exploited that power through exclusionary means in violation of, *inter alia*, Sherman Section 2.

Kodak’s defense was that its refusal to provide supplies and technical information was a legitimate exercise of its intellectual property rights. The Supreme Court, however, denied summary judgment for Kodak, ruling that it was possible to establish a Sherman Section 2 claim even where all the patents in question are valid. The Court reasoned that the exclusionary exercise of Kodak’s intellectual property rights could simply be a pretext for monopolizing the market. Absent any other legitimate business reason, such conduct would be an antitrust violation.

On remand, the Ninth Circuit ruled that Kodak’s exercise of its patents was simply a means for Kodak to acquire a monopoly in violation of section 2 of the Sherman Act. While Data General had held that a rebuttable presumption existed that the exercise of one’s legitimate IP rights could not be grounds for an antitrust action, the Ninth Circuit found that this presumption was rebutted by the ISOs. The decisive factor was not Kodak’s exercise of its rights, but its motivation and intent in doing so.

The Fifth Circuit has also affirmed a plaintiff’s treble damage judgment of more than \$ 15 million for a Sherman Section 2 claim that explicitly implicated above-cost pricing. In *Great Western Directories, Inc. v. Southwestern Bell Tel. Co.*,¹² Great Western and its co-plaintiff, Canyon Directories, published classified, or yellow pages, telephone directories in Texas and Oklahoma. Southwestern Bell published “white pages” for its telephone customers. “In order to publish the white pages [Southwestern Bell had to] compile and maintain a database of names, addresses, and telephone numbers of all its customers.”¹³ This compilation was known

⁸ 472 U.S. 585 (1985).

⁹ *Id.* at 605 (footnote omitted).

¹⁰ *Id.* at 605-11.

¹¹ 504 U.S. 451 (1992).

¹² 63 E.3d 1378, 1382 (5th Cir.), *amended*, 74 E.3d 6132 (5th Cir. 1996).

¹³ *Id.* at 1383.

as directory listing information (DLI). Southwestern Bell licensed DLI through its own subsidiary for use in publishing its yellow pages. Southwestern Bell also licensed DLI to independent publishers such as the plaintiffs.

Great Western and Canyon Directories contended that Southwestern Bell adopted a strategy to eliminate competition in the yellow pages directory market and to slow its declining market share. According to the plaintiffs, this strategy was implemented by a two-prong attack: (1) “raising the prices and imposing restrictive conditions on the sale of the DLI”; and (2) improving the quality of the yellow pages published by Southwestern Bell and “reducing the prices charged for the advertisements.” Southwestern Bell increased its DLI prices from \$0.30 to \$0.50 for the initial load and to \$1.00 for the update. Southwestern Bell “improved its classified directories in certain markets and instituted a rate reduction in Amarillo[, Texas]. The rate reduction consisted of a 40% across-the-board reduction in advertising rates” and additional advertising to advertisers who maintained existing expenditure levels. Great Western operated at a marginal profit of 2% of its sales. It contended that “the change in DLI prices forced [it] out of its Richardson[, Texas] market and prevented it from entering its Little Rock market.” However, the revenue and market shares of both plaintiffs increased after the DLI price change.

The Fifth Circuit began its analysis of the jury verdict by discussing the elements of a Sherman Section 2 violation. With respect to exclusionary conduct, the court stated that in order to establish a Sherman Section 2 violation, “it must be demonstrated that the defendant ‘willfully’ acquired or maintained its monopoly power.”¹⁴ The court also noted that a plaintiff does not have to prove that the conduct of the defendant “totally eliminated all competition or made it so unprofitable as to eliminate the plaintiff as a competitor.”¹⁵ Relying upon *Aspen Skiing Co.*, the court noted that a plaintiff is required to show that the monopolist’s conduct handicapped its competitors but does not have to establish that competitors were excluded. After discussing the evidence in some detail, the court concluded that there was ample evidence to support the jury’s verdicts of monopolization and attempt to monopolize under Sherman Section 2.

PREDATORY PRICING

Claims of “predatory” (*i.e.* below cost) pricing are actually of more recent vintage. While some older cases involve vague claims of predatory pricing,¹⁶ most cases challenging “predatory” pricing have been brought since the now-famous Areeda and Turner article in the *Harvard Law Review* in 1975.¹⁷ Under the Areeda-Turner proposed test, prices below marginal costs are predatory, and those above that level are not. Almost every circuit has been influenced by this proposed test for predation, although only a few have explicitly adopted the test.¹⁸

There is general consensus that the two principal elements of a predatory pricing claim are: (1) that the defendant has charged a price below the appropriate measure of cost in order to drive out or injure competition; and (2) that the defendant has a reasonable expectation that it will be able to raise prices in the future to levels higher than would be

¹⁴ *Id.* at 1384-85.

¹⁵ *Id.* at 1386.

¹⁶ See *e.g.*, *United States v. American Tobacco Co.*, 221 U.S. 106 (1911), *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

¹⁷ Areeda and Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697, 732-33 (1975).

¹⁸ Prices above short-term average variable cost are presumptively lawful as a matter of law and prices below average variable cost are presumptively predatory. This approach adopts the test proposed by Professors Areeda and Turner in 1975. See P. Areeda & D. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697, 732-33 (1975). Areeda and Turner used reasonably anticipated average variable cost as a proxy for marginal cost since the latter is difficult to calculate. *Id.* at 716. Circuits applying the anticipated average variable cost standard (or an equivalent formulation) include the First (*Clamp-All Corp. v. Cast Iron Soil Pipe Institute*, 851 F.2d 478, 483 (1st Cir. 1988) (below “incremental cost”), *cert. denied*, 488 U.S. 1007 (1989)), Second (*Northeast Tel. Co. v. AT&T Co.*, 651 F.2d 76, 88 (2d Cir. 1981) (below “reasonably anticipated marginal costs”), *cert. denied*, 455 U.S. 943 (1982)), Fifth (*Searns Airport Equip. Co., Inc. v. FMC Corp.*, 170 F.3d 518, 532-33 & n.14 (5th Cir. 1999) (interpreting *Brooke Group* as foreclosing any predatory pricing claim where the defendant’s prices were above average variable cost), and Eighth (*Henry v. Chloride*, 809 F.2d 1334, 1346 (8th Cir. 1987) (holding prices above average variable cost have strong presumption of legality)).

offered in a competitive market, and thereby make up its lost profits and obtain some additional gain.¹⁹

Since *Matsushita*, the courts have been very suspicious of predatory pricing claims. Although some of us believe that *Matsushita* was wrongly decided due to the Supreme Court's somewhat naïve view of Japanese business practices, there is general agreement with the conclusion that successful predatory pricing is a relatively rare occurrence, and that there are relatively few markets in which the natural and artificial entry barriers are great enough to sustain a sufficient recoupment period of monopoly prices to warrant serious antitrust concern. However, the view of some extreme Chicago School disciples that antitrust should *never* be concerned with predatory pricing because it can *never* harm consumers is not supported either by economic theory or by the case law. Indeed, recent refinements in economic analysis described below suggest that predatory pricing is cause for concern in certain types of markets. As the Supreme Court stated in *Brooke Group* in rejecting the argument that the interdependent pricing of an oligopoly presumptively can *never* provide a means for achieving recoupment:

A predatory pricing scheme designed to preserve or create a stable oligopoly, if successful, can injure consumers in the same way, and to the same extent, as one designed to bring about a monopoly. However unlikely that possibility may be as a general matter, when the realities of the market and the record of facts indicate that it has occurred and was likely to have succeeded, theory will not stand in the way of liability. See *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 466-67, 112 S.Ct. 2072, 2081-2082, 119 L.Ed.2d 265 (1992).

Brooke Group, 509 U.S. at 229.

EMERGING THEORIES AND RECENT CASES

There is impressive recent economic literature on the predatory use of contractual provisions and other strategies by dominant firms to erect barriers to entry and to maintain monopoly power.²⁰ What economics in the post-Chicago School era has re-discovered is that, while predatory pricing by monopolists may be an unlikely and/or unsuccessful strategy, other types of non-price predation are cheaper, less risky, and more often successful. As one prominent conservative economist has stated:

The reality is that doing these things has been enormously beneficial for the firms involved ... they can be very effective at imposing very high costs on entrants, but no cost at all on the dominant firm.²¹

Although these devices and strategies can take a variety of forms, they share the common purpose of creating entry barriers that have the effect of raising the costs of firms that try to compete with the dominant firm. Economists refer to the additional costs that the dominant firm is able to inflict on its rivals as a “tax” or “penalty.”²² It is an amount of

¹⁹ See ABA Antitrust Section, *Sample Jury Instructions in Civil Antitrust Cases* (3d. Ed. 1999) at C-50-55. Of course these elements implicate other subsidiary issues as well, including relevant market definition, monopoly power, and ease of entry.

²⁰ See, e.g., Aghion & Bolton, *Contracts as a Barrier to Entry*, 77 Am. Econ. Rev. 388 (1987); Brodley & Ma, *Contract Penalties, Monopolizing Strategies, and Antitrust Policy*, 45 Stan. L. Rev. 1161 (1993); Salop & Scheffman, *Raising Rivals Costs*, 73 Am. Econ. Rev. 267 (1983); Krattenmaker & Salop, *Competition and Cooperation in the market for Exclusionary Rights*, 76 Am. Econ. Rev. 109 (1986); Krattenmaker & Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale L.J. 209 (1986).

²¹ *Business Week*, February 23, 1998 at pp. 124-126 (quoting Dr. Frederick Warren-Boulton) See also, K. Baseman, F. Warren-Boulton & G. Worock, *Microsoft Plays Hardball: The Use of Exclusionary Pricing and Technical Incompatibility to Maintain Monopoly Power in Markets for Operating System Software*, 40 Antitrust Bull. 265 (1995).

²² See, e.g., Willard K. Tom, et al., *Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing*, 67 Antitrust L.J. 615 (2000). See also, Willard K. Tom, Deputy Director - Bureau of Competition - Federal Trade Commission, “*Anticompetitive Aspects of Exclusive Dealing and Related Practices*”, April 15, 1999 (paper delivered at ABA Antitrust Section Conference). See also, Richard M. Steuer, *Discounts and Exclusive Dealing*, 7 Antitrust 28 (1993).

money that the non-dominant firm must pay to sell its products. Most often the “tax” is in the form of an additional discount that the non-dominant firm must offer to buyers in order to compensate them for switching some of their purchases from the dominant firm to the non-dominant firm. Often this “tax” is substantial, so that the non-dominant firm cannot obtain additional sales by giving a *slightly* better price, its must offer a price *substantially* lower than that of the dominant firm.

The effect of the “tax” is to create a barrier to entry, a cost that must only be incurred by rivals to the dominant firm. Sometimes the tax or entry barrier is surmountable, but in certain types of markets, particularly those exhibiting network effects or those in which the minimum efficient scale is a large percentage of the total market, these devices can be very effective in handicapping new entry or expansion by existing rivals. Let me give you a hypothetical example:²³

Assume a market for widgets, which is a differentiated and intermediate product. There is a dominant manufacturer, with a single, smaller competitor. Assume that, due to a first mover advantage or some other factor, the dominant firm is so well established among consumers of the finished products of which widgets are a substantial component that the manufacturers of the finished products have a base, inelastic demand for the dominant firm’s widgets in 60 percent of their business. Now assume that the dominant firm charges a normal price to customers that purchase up to 69 percent of their widget requirements from the dominant firm, but offers a six percent discount to customers that purchase 70 percent or more of their widgets from the dominant firm, with the discount being given back to the first unit purchased. Viewed simplistically, this looks like just a six percent discount.

However, this discount is what economists call a “market share discount,” and even a modest “market share discount” can have a very strong tendency to shift purchases from the dominant firm’s rivals to the dominant firm. The reason is that the entire dollar value of the “discount” is concentrated on the decision whether to buy the marginal units between 60 and 70 percent. From the buyer’s standpoint, it faces a tax or penalty in the form of the loss of *all* cumulative discounts if the buyer buys a widget from another firm and that causes the buyer’s “market share” of purchases from the dominant firm to fall below 70 percent.

It might be very difficult for a competitor with a very small market share to match these incentives and penalties. The smaller competitor would have to match the total dollar amount of the lost discounts, and would have to spread that total dollar amount over a smaller number of units, requiring a substantially larger percentage discount. This disadvantage is magnified if, as may be the case, the smaller competitor is already operating below minimum efficient scale. Thus, under certain market conditions, the use of “market share” discounts could so constrict the market available to a non-dominant firm that its costs would be raised, and its ability to constrain the dominant firm’s higher-than-competitive prices could be eliminated.

The table below illustrates numerically how this might work. Assume that a buyer has a total demand of 10 widgets, a fixed (inelastic) demand for the dominant firm’s (Brand A) widgets for 60 percent of its sales,²⁴ and that Brand A sets a “market share” discount of six percent if the buyer purchases 70 percent of its requirements from Brand A. Correctly viewed, the six percent discount is not the roughly \$7 per unit it appears, but rather is really a \$49 discount for the incremental unit number seven.

²³ The example is borrowed from the paper by Willard Tom cited in Note 13 above, but is largely based upon the facts of *Concord Boat Corp., et al. v. Brunswick Corp., infra*.

²⁴ The fixed demand of 60 percent may be due to “locked-in” customers, entrenched customer preferences for Brand A, a less-developed dealer or service network for Brand B resulting in the unavailability of Brand B in certain geographic areas, or other factors.

WIDGET PRICES Effective Prices to Hypothetical Buyer		
Total Market: 10 Units Minimum Efficient Scale: 4 Units		
	Effective Price Of Brand A Widgets Cost: \$100	Effective Price of Brand B Widgets Cost at current scale: \$108
Units 1-6	\$115	N.A.*
Nominal Group of Units 1-7	\$108 (\$115 less 6%) (Total discount \$49)	N.A.*
Unit 7	\$66 (\$115 less \$49)	Cannot sell at profit.
Units 8-10	\$108	\$108
* The buyers of units 1-6 would not switch to Brand B products at this price differential.		

This table also illustrates that these types of devices can harm competition by preventing a smaller rival from reaching minimum efficient scale, even if the smaller firm is capable of being as efficient (or more efficient) than the dominant firm if they could achieve such scale.

The conduct of Microsoft Corporation, challenged by the Justice Department in two separate civil actions, is the most well-known example of the new kinds of predation. In *Microsoft I*,²⁵ after an investigation of various Microsoft practices, the government sued to enjoin the use by Microsoft of what was called the “per processor” license fee. In many of its licensing arrangements with PC manufacturers Microsoft licensed the use of Microsoft’s operating system on a “per processor” basis. In other words, the PC maker paid Microsoft a license fee for each PC it shipped, *whether it contained Microsoft’s operating system or that of one of Microsoft’s competitors*. Note the similarity to the “factory output clause” in *United Shoe Machinery*.

Although Microsoft would license its operating system under terms not including the “per processor” license, it would do so only at much higher prices. Thus, since PC makers needed the lowest prices so that they could compete with other PC makers who agreed to the “per processor” license, most PC makers ended up agreeing to pay the “per processor” license.

The effect of this practice was that PC makers would essentially have to pay *twice* for an operating system license in any PC they made using a non-Microsoft operating system. They would pay Microsoft a license fee even if the PC had another operating system in it and, of course, they would have to pay a license fee to the seller of the non-Microsoft operating system for each PC with such an operating system. The result was a very large “tax” or entry barrier; for a rival operating system seller to make a sale, it would have to discount its price in an amount equal to the per processor license fee the PC maker would have to pay to Microsoft.

Microsoft I was settled by a consent decree that prohibited the use of such license agreements.²⁶ Unfortunately, by that time Microsoft’s dominance was so firmly entrenched, and supported by its emerging dominance in related markets for applications software, that the elimination of the per processor license provided only limited relief.

²⁵ See 59 Fed. Reg. 42845 *et seq.*
²⁶ See 59 Fed. Reg. 42854.

In addition, of course, Microsoft had also begun using additional business strategies to extend its dominance. These strategies were challenged by the Justice Department in *Microsoft II*.²⁷ As you all know, the District Court found in favor of the government. On June 28, 2001 the United States Court of Appeals for the District of Columbia affirmed in part, reversed in part, and remanded for further proceedings. *United States v. Microsoft Corp.*, ___ F.3d ___ (D.C. Cir. 2001) 2001 WL 721343. As of the date of this article (early July, 2001) there has been much comment in the popular press about the decision, most of such comment picking up on the “spin” given the decision by the parties. There has been little substantive analysis of the decision, and it is beyond the scope of this article to analyze the decision in detail; however, a few comments are appropriate.

First, setting aside the issues of the remedy and the conduct of the trial judge, the big news out of the decision is that the Court of Appeals upheld and validated the core of the government’s case against Microsoft. The core elements of the government’s case were:

1. The relevant market was the market for licensing of all Intel-compatible PC operating systems world wide;
2. Microsoft held a dominant, monopoly share of that relevant market;
3. Microsoft had engaged in a variety of predatory, exclusionary conduct in order to maintain its monopoly position;
4. Microsoft had non-existent, pretextual and/or insufficient pro-competitive justifications for the conduct; and
5. Microsoft’s conduct had restrained and injured competition in violation of Section 2 of the Sherman Act.

On each of these main points the Court of Appeals affirmed the District Court. Although the Court of Appeals found, as to *some* of the challenged Microsoft conduct, that the conduct was either non-exclusionary or competitively justified, it found most of the challenged conduct unlawful under Section 2. Importantly, in doing so, the Court of Appeals rejected, either implicitly or explicitly, the *per se* defenses often proffered by monopolists in these cases, discussed *infra*. The conduct found unlawful by the District Court and the Court of Appeals in *Microsoft* was varied, but all of the conduct was designed to raise entry barriers in the relevant market by restricting the sales opportunities of Microsoft’s rivals, with little or no offsetting quality or efficiency benefits for consumers. Thus, for example, Microsoft’s varied license restrictions with OEMs regarding Windows and the use of browsers other than Microsoft’s Internet Explorer was determined to have:

[R]educed rival browsers’ usage share not by improving its own product but, rather, by preventing OEMs from taking actions that would increase rivals’ share of usage.²⁸

The District Court and Court of Appeals made similar findings regarding other Microsoft conduct which had a similar purpose and effect.

²⁷ The government’s Complaint and many other materials from the case are available at the Antitrust Division’s website “<http://www.usdoj.gov>.”
²⁸ Slip. Op. p. 33.

In *Concord Boat*,²⁹ the case in which I was lead trial counsel, the plaintiffs were 21 firms that manufactured pleasure boats powered by stern drive marine engines, and a buying group, Independent Boat Builders, Inc. The defendant was Brunswick Corporation, the dominant seller of stern drive marine engines with about 80% of the market. Brunswick is also the largest pleasure boat manufacturer in the world, as a result of its acquisition in the mid-1980s of the two largest boat manufacturers in the world. Thus, Brunswick was both the dominant supplier to the plaintiffs of a critical component in the manufacture of a pleasure boat,³⁰ as well as the plaintiffs' largest competitor. Moreover, the relevant market (stern drive engines sold in North America) was rather small in terms of the total number of units (about 100,000 per year), and minimum efficient scale was between 25% and 40% of the market. The market has substantial entry barriers, and exhibits certain network effects. These large, complex engines are both sold and serviced through networks of both boatbuilders and marine dealers. Thus, the structure and characteristics of the relevant market was conducive to the exercise of market power by a dominant firm.

Beginning in the latter part of the 1980s Brunswick began using "market share" agreements in its marketing of stern drive engines. Although the terms varied slightly over the years, generally the structure was that, in order to achieve the highest rebates and/or discounts on their engine purchases, the boatbuilder had to agree to purchase at least 80% of its engine requirements from Brunswick. During some periods the boatbuilder had to commit to the 80% level for a period of three years in order to get the maximum discount.

For the reasons described above, the effect of these "market share" agreements was to create a very substantial artificial barrier to entry in the form of a "tax." The dominant share Brunswick enjoyed enabled it to deprive its rivals of the only business strategy that could work, *i.e.* small increases in purchases at many boatbuilders. Boatbuilders were faced - at least at the 80% market share level - with the equivalent of an "all or nothing" choice like the computer OEMs faced with Microsoft's "per processor" license fee. And since the minimum efficient scale for a manufacturer of stern drive engines was between 25% and 40% of the market, and Brunswick's rivals were substantially below that level, those rivals could not afford to deeply discount their products to compensate boatbuilders for the loss of the cumulative discounts. After a ten-week trial, the jury found that Brunswick's agreements unreasonably restrained trade and constituted unlawful monopolization, and awarded the plaintiff boatbuilders over \$133,000,000 in damages.

Unfortunately, as noted, in March of this year the Eighth Circuit reversed the jury's verdict and entered judgment for defendant Brunswick. In a decision reflecting enormous naivete about antitrust precedent and business conduct, and a shocking inattention to the record of a ten-week trial, a panel of the Court concluded that the challenged conduct was not anti-competitive as a matter of law. In doing so, the Court appeared to accept some of the "*per se*" defenses monopolists have offered when their conduct has been challenged, as discussed below.

Although *Concord Boat* was the first of the cases using these emerging theories to get to trial (beating *Microsoft III* to trial by about six months), it was followed by the trial in *LePage's, Inc. v. 3M*,³¹ in which the jury also returned a multi-million dollar verdict for plaintiffs. The defendant 3M enjoys a dominant market share (90%) in the market for invisible and transparent tape. It faced competition from LePage's in the private label segment of that market. Essentially, LePage's made private label tape for retailers such as K-Mart, Walmart and others.

²⁹ *Concord Boat Corp., et al. v. Brunswick Corp.*, 21 F. Supp.2d 923 (E.D. Ark. 1998) and 34 F. Supp. 1125 (E.D. Ark. 1998), *rev'd*, 207 F.3d 1039 (8th Cir. 2000); *cert. denied*, 121 S.Ct. 428 (2000).

³⁰ On average the cost of the engine is approximately 50% of the cost of making a boat.

³¹ See *LePage's, Inc. v. 3M*, No. Civ. A. 97-3783, 2000 WL 280350 (E.D.Pa. March 14, 2000 - order denying defendant's post-trial motions); 1999 WL 346223 (E.D. Pa. May 14, 1999 - order denying defendant's motion for summary judgment); 1997 WL 734005 (order denying defendant's motion to dismiss).

3M adopted a marketing strategy referred to as “bundled rebates.” That is, 3M offered its most attractive rebates and discounts to large retailers *only* if they achieved certain aggressive sales targets for several products. In this case 3M “bundled” both tape and other desirable products like Post-It notes. Since LePage’s makes only tape, and not sticky notes, if LePage’s wanted to match the price discounts it would have to match the total discounts for all products “bundled” by 3M. The effect, like the market share discounts in *Concord Boat*, was to “tax” the retailers’ purchases of products from the dominant firm’s rivals. After an eight-week trial, on October 18, 1999 the jury returned a verdict for the plaintiff, finding that the conduct violated Section 2 of the Sherman Act and awarding damages (before trebling) of almost \$23 million. An appeal of the jury’s verdict is pending in the Third Circuit.

Other cases raising similar issues are still in the litigation pipeline. Among these other cases is *R.J. Reynolds Tobacco Co. v. Philip Morris, Inc.*³² In that case the plaintiff R.J. Reynolds Tobacco Co. challenged the implementation of a cigarette marketing program by Philip Morris which tied its most favorable discounts to the retailer’s agreement to limit the percentage of in-store display space devoted to competitors’ products. The district court granted the motion of plaintiff for a preliminary injunction barring Philip Morris from implementing the program. The court found that the challenged marketing program “is a classic example of market power to gain a competitive advantage by handicapping rivals and diminishing their ability to compete. The [marketing] program is compelling to retailers precisely because of PM’s (Philip Morris’) existing dominance.”³³ In granting the preliminary injunction, the court noted that defendant Philip Morris had in excess of 50% of the market, in a highly concentrated industry in which the four leading cigarette manufacturers accounted for approximately 97% of all domestic sales. The court also noted the cigarette manufacturing industry is characterized by high barriers to entry, evidenced by the fact that there has not been a significant new entrant into the market in over 80 years. The court also took note of the fact, given the current economic, political and regulatory environment, that it is unlikely that any significant new entrants will emerge in the foreseeable future. The court also found that in-store display space at the point of purchase is of critical importance in the cigarette industry, particularly in light of new limitations on alternative forms of advertising as a result of the legislation and settlement of the tobacco litigation. The court found that by using its market power to limit the ability of its rivals to obtain in-store display space, Philip Morris had unreasonably and unfairly restrained trade.

In *PepsiCo, Inc. v. The Coca-Cola Co., Inc.*³⁴ Plaintiff PepsiCo sued Coca-Cola over Coke’s marketing strategies in the market for the sales of fountain dispensed soft drinks distributed through food service distributors in the United States. PepsiCo alleged that Coca-Cola had monopoly power in that market by virtue of its 90% market share. Prior to 1997, PepsiCo had been at a significant disadvantage in the market for fountain dispensed soft drinks because of its acquisition in the 1970s and 1980s of restaurant chains such as Taco Bell and others which featured PepsiCo products. Coca-Cola had capitalized on PepsiCo’s restaurant ownership by convincing other restaurant chains that PepsiCo had become their competitor and therefore they should spurn Pepsi and support Coke. In 1997, however, PepsiCo changed its business strategy. PepsiCo divested itself of its restaurant chains and negotiated new arrangements with its bottlers which allowed it to distribute fountain-dispensed soft drinks through food service distributors rather than through local bottlers. Thus, according to Pepsi’s complaint, PepsiCo emerged as a new and revitalized threat to Coca-Cola’s market dominance. In response, Coke allegedly embarked on a strategy to use its market power to perpetuate its monopoly by threatening food service

³² 60 F. Supp.2d 502 (M.D.N.C. 1999) (Bullock, Chief Judge).

³³ *Id.* at *9.

³⁴ 1998 WL 547088 (S.D.N.Y. 1998), 1998-2 Trade Cas. ¶ 72,257.

distributors with the loss of Coke if they would dare to carry Pepsi for their customers who wanted Pepsi. Coke, in fact, did cut off any distributors that decided to carry Pepsi, in addition to Coke. The District Court recently granted summary judgment in favor of Coke, finding that the evidence did not support Pepsi's market definition.³⁵

Although Coke's business strategy is somewhat different than those we observed in *Concord Boat*, *Microsoft* and *LePage's*, it is similar in that it forced distributors to make essentially an "all or nothing" choice between selling Coca-Cola or selling Pepsi. The effect of forcing this "all or nothing" choice on distributors, when Coke's existing dominance makes it a virtual necessity for distributors to carry Coke, was to create enormous artificial entry barriers for PepsiCo in the fountain-dispensed beverage market. The cited opinion denied, on appropriate grounds, Coke's Rule 12 motion.

Another interesting recent example of the use of these emerging theories is the *Dentsply* case.³⁶ In that case, the Justice Department has challenged arguments between Dentsply, the dominant seller of artificial teeth, and dealers who resell them to dental laboratories that use the teeth in manufacturing finished dentures. The agreements provided, among other things, that the dealers would not add new lines of competitors' premium artificial teeth. The government also alleges that Dentsply has signed up many more dealers than it needs, thus further limiting the availability of dealers which are needed by its competitors. Defendant's motion for summary judgment was recently denied.³⁷

In the category of predatory pricing cases, the most interesting recent case is the government's civil action against American Airlines.³⁸ The Justice Department is the first plaintiff of which I am aware that appears to make use of the "profit sacrifice" theory of predation proffered by economists Janusz Ordover and Robert Willig.³⁹ Under this theory, in markets with certain characteristics it is appropriate to measure "costs" for purposes of predation analysis by including foregone profits that could have been earned by the monopolist if it had employed its assets in other markets rather than using them to increase capacity in the subject market.

In *American Airlines* the claim is that American used predatory pricing to drive competing low-cost carriers (LCCs) out of certain city-pair markets originating at Dallas-Ft. Worth. The government argues that American's prices are "below variable cost" both in the traditional sense *and particularly* if foregone profits are included. If the government ultimately is successful, then predatory pricing theory will have been expanded in an important way.

On April 27, 2001 the District Court granted summary judgment to American Airlines, rejecting the government's new theory of price predation.⁴⁰ The Department of Justice recently announced that it will appeal the District Court's decision. The decision on appeal perhaps will be instructive on whether the courts are open to considering new theories of price predation, or consider themselves limited to considering only traditional, Areeda/Turner "cost" analysis.

"PER SE" DEFENSES PROFFERED BY MONOPOLISTS

Monopolists in these cases involving marketing strategies, particularly those where the facts are especially bad for them, have argued there are certain "*per se*" defenses which

³⁵ *Pepsi Co., Inc. v. The Coca-Cola Co.*, 114 F. Supp.2d 243 (S.D.N.Y. 2000).

³⁶ *United States v. Dentsply Intl, Inc.*, Civ. No. 99-005 (D. Del. 1999). The Complaint is available on the Antitrust Division website.

³⁷ 2001 U.S. Dist. Lexis 9057.

³⁸ *United States v. AMR Corp., American Airlines, Inc. and AMR Eagle Holding Corp.*, Civ. No. 99-1180-JTM (D. Kan. 1999).

³⁹ See, *An Economic Definition of Predation: Pricing and Product Innovation*, 91 Yale L.J. 8 (1981).

⁴⁰ *United States v. AMR Corp.*, 140 F. Supp.2d 1141 (D.Kan. 2001).

immunize them from liability. The newest of these defenses, and the one asserted with the most vigor (because it is truly a “silver bullet” defense), is that such marketing strategies, whether they be market-share agreements, bundled discounts, discounts designed to reduce rivals’ ability to obtain display space, or others, are immune from antitrust liability so long as the prices of the products to which the marketing strategy is attached are above cost.⁴¹ This argument is creatively derived from the Supreme Court’s decisions in *Matsushita* and *Brooke Group*, wherein the Supreme Court - in the context of claims of predatory pricing - held that prices below an appropriate measure of cost are *per se* lawful. Defendants in these cases have argued that this principal should be extended to immunize any marketing practice, regardless of its actual effects, so long as the price is above the defendant’s cost.⁴² Until the decision of the Eighth Circuit in *Concord Boat*, the only courts that have explicitly considered this argument have rejected it, and appropriately so. As most courts have observed, there is nothing in the text or the rationale of *Matsushita* or *Brooke Group* that can fairly be read as suggesting that those cases intended to eliminate all Sherman Section 2 causes of action *except* predatory pricing claims. For that, of course, would be the effect of the adoption of such a rule.

The Eighth Circuit, unfortunately, fell victim to the seductive (but erroneous) charms of this simplistic defense. Accepting the invitation of the defendant to rely exclusively upon predatory pricing cases, the Eighth Circuit adopted a policy of “great caution and a skeptical eye when dealing with unfair pricing claims.”⁴³ Although the language of the opinion is murky, the Court arguably established a presumption that in *any* Sherman Section 2 case, conduct is presumably lawful so long as the *price* at which the monopolist sells its product is above its cost.⁴⁴

The fallacy, indeed the perversity, of such rule seems abundantly clear to knowledgeable antitrust scholars and practitioners, but not to the panel of the Eighth Circuit. The Supreme Court has consistently observed that the *harm* from unlawful monopolization is that it enables the monopolist to charge an anticompetitively high, *e.g.*, supracompetitive, price.⁴⁵ Indeed, the law in the Eighth Circuit itself is that the ability of large firms to charge supracompetitive prices is one of the chief “evils” which the Sherman Act is designed to prevent.⁴⁶

However, in *Concord Boat* the panel of the Eighth Circuit arguably has established that the *only* Sherman Section 2 claim that can survive its scrutiny is a “predatory pricing” claim. Yet, as the Supreme Court has properly held, “predatory pricing schemes are rarely tried, and even more rarely successful.”⁴⁷ The Eighth Circuit confused the issue in *Concord Boat*. There, the issue - and challenged conduct - was *not* the price that was charged (as it is in predatory pricing cases). Rather, the issue - and the conduct challenged - in *Concord Boat* was whether the *conditioning of a discount* on the buyer’s agreement to purchase almost all of its needs from the monopolist created entry barriers and restrained competition. On this point the evidence in the record of *Concord Boat* - which was ignored by the panel - was overwhelming.

This “above-cost” defense has been roundly rejected by commentators.⁴⁸ However, the success of this red-herring defense in *Concord Boat* raises the possibility that decisions in other cases may accept this defense. Fortunately, in *Microsoft III* the Court of Appeals appeared, at least implicitly, to reject this defense. All of Microsoft’s conduct challenged by the government was related to a product sold at a specified price that was not “predatory” in

41 See, *e.g.*, *Concord Boat* at 21 F. Supp.2d at pp. 929-930; see also *Tom*, *supra* n. 13.

42 See, *e.g.*, *LePage’s*, *supra.*; *Concord Boat*, *supra.*; see also *SmithKline v. Eli Lilly & Co.*, 575 F.2d 1056 (3rd Cir. 1978). See also, Ronald W. David, *Pricing With Strings Attached: At Sea in Concord Boat and LePage’s*, 14 Antitrust 69 (2000).

43 *Concord Boat*, 207 F.3d at 1060.

44 *Id.* at 1061-62.

45 See, *e.g.*, *Hawaii v. Standard Oil Co.*, 405 U.S. 251, 262 n.14 (1972); *Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 486, 489 (1968).

46 See, *Henry v. Chloride*, 809 F.2d 1334, 1339 (8th Cir. 1997).

47 *Matsushita*, 475 U.S. at 589.

48 See, *e.g.*, Willard K. Tom, *supra.*, Note 13. David A. Balto, *Networks and Exclusivity: Antitrust Analysis to Promote Network Competition*, 7 Geo. Mason L. Rev. 523, 569-570. Richard M. Steuer, *supra.*, Note 13.

the sense of being below an appropriate measure of cost. Yet the Court of Appeals did not regard the fact that the products were sold above cost as a defense to otherwise exclusionary conduct. Although the Court of Appeals did cite *Brooke Group* for the proposition that “in very rare circumstances a price may be unlawfully low, or ‘predatory,’”⁴⁹ and later noted that it rejected “the District Court’s condemnation of low but non-predatory pricing by Microsoft,”⁵⁰ the Court then went on, properly in this author’s view, to condemn the exclusivity agreements which were “purchased” from the Independent Software Vendors.⁵¹ This seems to be the correct analysis, considering not whether the “price” of a product is below cost, but whether the conditions attached to the transaction at a given price - in *Microsoft III* the agreement to deal exclusively with Microsoft - restrains competition. As plaintiffs in *Concord Boat* argued, the challenged restraint is not the price, it is the strings attached to the price.

Another “*per se*” defense proffered in some of these cases is the argument that, so long as agreements that have the effect of restricting the buyers’ purchases of rivals products are not “100% exclusive,” they cannot be unlawful exclusive dealing arrangements.⁵² This argument has similarly been appropriately rejected. As the district court in *Concord Boat* correctly observed, this argument is not only inconsistent with the mandate of *Kodak*⁵³ that cases be resolved on their own unique facts and not by the use of presumptions, but it also would establish in the law a “bright line” that would appear irrational. As the district court in *Concord Boat* observed, under such a rule an agreement pursuant to which the buyers would agree to purchase 99% of their requirements from the dominant seller would be *per se* lawful, while an identical agreement at the 100% level would likely be found unlawful, even though in both situations the competitive effects would be very similar. Even the misguided Eighth Circuit panel rejected the “100% exclusive” defense.⁵⁴

The Court of Appeals in *Microsoft III* also rejected this argument, at least in the Sherman Section 2 context.⁵⁵ The Court noted that the District Court had found no violation of Sherman Section 1 since Microsoft had not “completely excluded Netscape from reaching any potential user by some means of distribution, however ineffective,”⁵⁶ and also noted that the government had not appealed this finding.⁵⁷ The Court of Appeals then, however, held that the exclusivity agreements could violate Section 2 even if they did not violate Section 1,⁵⁸ and even if the agreements did not “completely exclude” a competitor:

... [W]e agree with plaintiffs that a monopolist’s use of exclusive contracts, in certain circumstances, may give rise to a Section 2 violation even though the contracts foreclose less than the roughly 40% or 50% share usually required in order to establish a Section 1 violation.⁵⁹

The Court also recognized the minimum efficient scale issue missed by the Eighth Circuit in *Concord Boat*:

... Microsoft’s deals with the IAPs [Internet Access Providers] clearly have a significant effect in preserving its monopoly; they help keep usage of Navigator below the critical level necessary for Navigator or any other rival to pose a real threat to Microsoft’s monopoly.⁶⁰

49 Slip. Op. at p. 42.

50 *Id.* at p. 53.

51 *Id.* at p. 53-55.

52 See, e.g., *Concord Boat* at 21 F. Supp.2d at pp. 932-33.

53 *Eastman Kodak Co. v. Image Tech. Serv., Inc.*, 504 U.S. 451 (1992).

54 *Concord Boat*, 207 F.3d at 1058-59.

55 Slip. Op. at pp. 45-46.

56 *Id.*

57 *Id.*

58 The opinion strongly hints that the Court of Appeals might have found a Section 1 violation if that issue had been presented.

59 *Id.*

60 *Id.* at p. 46.

A related, but slightly different, argument by some defendants has been that agreements that do not explicitly provide for exclusivity cannot violate the Sherman Act. This argument has also been routinely rejected and is plainly inconsistent with the older cases cited above, including *United Shoe Machinery*, *Carter Carburetor*, and *F.T.C. v. Brown Shoe*. The fact that anticompetitive effects are achieved through incentives for exclusivity, rather than binding contractual commitments, does not minimize, nor legalize, those effects.

FACTUAL DEFENSES OFFERED BY MONOPOLISTS

Monopolists in these cases also offer “factual” defenses that rest on erroneous assumptions. These differ only in degree from the “*per se*” defenses described above, in that the monopolists focus more on the particular market at issue. One of these arguments is the “other sellers are doing the same thing” claim. The argument is that the dominant seller is simply using the same marketing techniques that other, non-dominant sellers are using. This is a very appealing argument to a jury, but is plainly not a defense as a matter of law. Even Justice Scalia - not widely regarded as pro-plaintiff when it comes to antitrust analysis - has said:

Where a defendant maintains substantial market power, his activities are examined through a special lens: Behavior that might otherwise not be of concern to the antitrust laws — or that might even be viewed as procompetitive — can take on exclusionary connotations when practiced by a monopolist.⁶¹

Another argument sometimes made by monopolists, and one that was argued vigorously by defendant Brunswick in the *Concord Boat* case, is that there are other, larger firms that are either in the market or might enter. The argument is that the presence of rivals that are larger firms precludes anticompetitive effects. Of course, this is nonsense; even very large firms will not deliberately lose money to try to overcome artificial entry barriers. A smaller firm with market power can very effectively exclude larger firms if market conditions are right. Moreover, if this argument were accepted, then no market could be monopolized, because Microsoft and General Motors are big enough to enter *any* market, despite artificial entry barriers. Those firms achieved their size by being smart enough not to throw away their money trying to enter markets with substantial artificial entry barriers.

In *Concord Boat* the Eighth Circuit, while not explicitly endorsing this defense, did so implicitly by rejecting the plaintiffs’ evidence of substantial entry barriers and concluding, contrary to the overwhelming evidence of net exit from the market, that “new competitors such as Toyota” might successfully enter because Brunswick’s prices were significantly above cost.⁶²

IMPORTANT ECONOMIC ISSUES RAISED BY THESE CASES

It is important to remember that each of these cases, and any other case challenging similar attempts by a dominant firm to handicap its rivals, raise important factual and economic issues that counsel must assess early in the case. As the Supreme Court emphasized in the *Kodak* decision, antitrust cases must be resolved each upon their own unique facts. Among the principal issues that counsel must assess is the question of the existence and magnitude of both natural and artificial barriers to entry. Most economists would agree that in the absence of at least some natural entry barriers, even a firm with what appears to be a dominant market share will usually not be able to adopt business strategies that can create additional artificial entry barriers that would significantly handicap rivals. Another way of

⁶¹ *Kodak*, 504 U.S. at 488, (Scalia, J. dissenting). See also *Berkey Photo, Inc. v. Eastern Kodak Co.*, 603 F.2d 263, 275 (2d. Cir. 1979); Philip Areeda & Herbert Hovenkamp, *Antitrust Law* §802d (1996).

⁶² *Concord Boat*, 207 F.3d at 1059. The Court utterly ignored the evidence that Brunswick’s conduct had foreclosed so much of the market that *no* other market participant, whether incumbent or new entrant, could achieve minimum viable scale.

looking at this is assessing the question of whether or not the dominant firm, even with a very large market share, in fact has market power or monopoly power. For a firm to have monopoly power it must have the ability to control price or exclude competition.⁶³ Thus, if there has been substantial recent entry into the market, and particularly if that entry has resulted in declines in price or increases in output, it may be that a finding of monopoly power is unwarranted. On the other hand, evidence of prices which are high relative to cost, or evidence of lack of recent entry, may support an inference of monopoly power.

Also relevant to the issue of entry barriers and monopoly power is the question of whether there are alternative distribution channels available to potential rivals. This is really a question of the proper definition of the relevant market. For example, it is likely that the explosive expansion of sales over the Internet will affect the analysis of whether various distribution restraints with respect to retailers can truly limit the sales opportunities of rivals. Again, recognizing this issue does not presume the result - one must carefully analyze the market to determine whether or not there are other distribution channels that are realistic alternatives.

Of course, the ultimate question in these cases is whether or not there are reasonably demonstrable anticompetitive effects from the challenged conduct. Thus, even marketing strategies by dominant firms that appear likely to result in some restraint on competition cannot be successfully challenged unless one can credibly allege, typically through the testimony of an expert economist, that prices have been increased or output restricted as a result of the challenged conduct. This is not always an easy question to answer. Moreover, it is complicated by the fact that the analysis in these cases is typically done under the "rule of reason," which also requires a consideration of any proffered efficiencies and pro-competitive effects as well. Finally, of course, even in the case where there are efficiencies or pro-competitive effects, the challenged conduct cannot survive if there exist less restrictive alternatives that would produce the same efficiencies or pro-competitive effects.

Although the decision in *Concord Boat* was disheartening to advocates of thoughtful, fact-based analysis of alleged predatory conduct, one can remain hopeful. The Court of Appeals in *Microsoft III* correctly applied mainstream antitrust doctrine in light of new economic learning and found liability for a variety of exclusionary conduct. Moreover, the history of Sherman Act jurisprudence has consistently demonstrated that judges tend to be "behind the curve" of the cutting edge of economic scholarship. Since most economists, even some who were once stalwarts of the Chicago school, now recognize that economic theories are no substitute for factual analysis, and that firms with market power can be quite creative in exploiting that power, one can hope that judges will learn these same lessons.

63 *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966).