

Predatory Conduct Under Section 2 of the Sherman Act: Do Recent Cases Illuminate the Boundaries?

K. Craig Wildfang*

I. INTRODUCTION..... 323

II. HISTORIC OVERVIEW: SHERMAN ACT SECTION 2 PREDATION 324

III. PREDATORY PRICING 327

IV. EMERGING THEORIES AND RECENT CASES 328

V. MICROSOFT CASES..... 334

VI. *CONCORD BOAT*..... 339

VII. *LEPAGE’S V. 3M* 342

VIII. *R.J. REYNOLDS V. PHILIP MORRIS*..... 346

IX. *PEPSICO V. COCA-COLA* 347

X. *DENTSPLY* 348

XI. *AMERICAN AIRLINES* 351

XII. PER SE DEFENSES PROFFERED BY MONOPOLISTS 352

XIII. FACTUAL DEFENSES OFFERED BY MONOPOLISTS 354

XIV. IMPORTANT ECONOMIC ISSUES RAISED BY THESE CASES 355

I. INTRODUCTION

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 recent economic scholarship. This Article examines whether the ultimate result of this litigation and scholarship will mark new boundaries for the conduct of firms with market power. Whether new boundaries are clear or not, antitrust practitioners and corporate counsel must carefully weigh the antitrust risks entailed by business strategies designed to entrench or to exploit market power. Although the most well-known example of such conduct is the Microsoft case,¹ there are many other cases that raise similar issues.

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 of the Sherman Act. In my

* Partner, Robins, Kaplan, Miller & Ciresi, L.L.P. The author wishes to thank his colleagues Christopher W. Madel, David A. Balto, and Ryan W. Marth for their many helpful comments on early drafts of this paper.

1. United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001).

view, courts and scholars have too often been willing to tolerate behavior by firms with market power in the belief that competitive harm is unlikely. 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 observed the real world anticompetitive effects of successful predation.

II. HISTORIC OVERVIEW: SHERMAN ACT SECTION 2 PREDATION

For much of the past quarter century, predatory pricing has been the focus of much of the litigation under section 2. 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 that we would now label “predatory.” Courts readily condemned conduct by dominant firms that created incentives not to deal with the firm’s competitors. These cases establish antitrust principles that support the emerging theories of predation and help provide guidance in assessing the behavior of firms with market power in today’s modern economy. The following are a few examples of such cases and principles.

One of the earliest cases is *United States v. Terminal Railroad Association*.⁶ Although most commonly cited as a refusal to deal or essential facilities case, this famous case is really an early example of raising rivals’ costs and erecting entry barriers. The 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 that obtained control over all of the bridges over the Mississippi River connecting East St. Louis to St. Louis, and all related terminal facilities.⁷ The Terminal Association refused to permit other railroad companies to use the bridges or terminal facilities.⁸ 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.⁹ The Supreme Court properly held that the conduct was “an obstacle, a hindrance, and a restriction upon interstate commerce”¹⁰ and therefore violated sections 1 and 2 of the Sherman Act.

Another early case is *United Shoe Machinery Corp. v. United States*.¹¹ Although the action was brought under the exclusive dealing provisions of section 3 of the Clayton

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. Montfort of Colo., Inc.*, 479 U.S. 104, 117 (1986).

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

6. *United States v. Terminal R.R. Ass’n*, 224 U.S. 383 (1912).

7. *Id.* at 391.

8. *Id.* at 393.

9. *Id.*

10. *Id.* at 405.

11. *United Shoe Mach. Corp. v. United States*, 258 U.S. 451 (1922).

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.”¹² 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 shoemaking machinery of United’s competitors. In language that 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 use 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.¹³

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.”¹⁴ The economic effects of such a provision are remarkably similar to the Microsoft “per processor license” that the United States challenged in *Microsoft I* seventy years later, which is discussed below.¹⁵

In another early case, *Carter Carburetor Corp. v. Federal Trade Commission*,¹⁶ the Eighth Circuit applied the rationale of *United Shoe* in upholding the findings and conclusions of the Federal Trade Commission (FTC) 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,¹⁷ by tying its most favorable discounts to service stations’ agreements not to take on new lines of competing

12. *Id.* at 455.

13. *Id.* at 457-58.

14. *Id.* at 457.

15. Proposed Final Judgment and Competitive Impact Statement; *United States v. Microsoft Corp.*, 59 Fed. Reg. 42,845 (Dep’t of Justice Aug. 19, 1994) [hereinafter *Microsoft I*].

16. *Carter Carburetor Corp. v. Fed. Trade Comm’n*, 112 F.2d 722 (8th Cir. 1940).

17. *Id.* at 733 (finding along with the FTC that the “action of petitioner also tends to create [a] monopoly”).

carburetors.¹⁸ 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 express terms in the contracts. . . .

. . . .

It follows that 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 upon the number of automobiles equipped with that 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.¹⁹

Finally, in *Federal Trade Commission v. Brown Shoe Co.*, another predatory exclusion case, the Supreme Court held that economic incentives toward exclusive dealing could, in appropriate circumstances, be anticompetitive.²⁰ In that case the Court considered Brown Shoe's practice of entering into franchise agreements with retail shoe stores that 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.²¹

The Court noted that the FTC's trial examiner had found that Brown's contracts "effectively foreclosed Brown's competitors from selling to a substantial number of retail shoe dealers."²² The Court found that Brown's contracts "conflict[ed] with the basic policies of the Sherman and Clayton Acts."²³

18. *Id.* at 732.

19. *Id.* at 732-33; *see also* *Standard Oil Co. v. United States*, 337 U.S. 293 (1949) (discussing the Court's analysis in *Carter Carburetor Corp.*); Thomas G. Krattenmaker et al., *Monopoly Power and Market Power in Antitrust Law*, 76 GEO. L.J. 241 (1987) (discussing how courts define market power and monopoly power).

20. *Federal Trade Comm'n v. Brown Shoe Co.*, 384 U.S. 316 (1966).

21. *Id.* at 320.

22. *Id.* at 319.

23. *Id.* at 321.

III. PREDATORY PRICING

Relative to monopolization claims, “predatory” (below cost) pricing claims are actually of more recent vintage. While some older cases involve vague claims of predatory pricing,²⁴ most cases challenging “predatory” pricing have been brought since the now-famous Areeda and Turner article in the *Harvard Law Review* in 1975.²⁵ 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 it.²⁶

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 offered in a competitive market, and thereby make up its lost profits and obtain some additional gain.²⁷

Since *Matsushita*, the courts have been very suspicious of predatory pricing claims. Although some 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 facts indicate that it has occurred and was likely to have succeeded, theory will not stand in the way of liability.²⁸

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

25. Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

26. See, e.g., *Kelco Disposal, Inc. v. Browning-Ferris Indus. of Vt., Inc.*, 845 F.2d 404, 407 (2d Cir. 1989), *aff’d on other grounds*, 492 U.S. 257 (1989); *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1344 (8th Cir. 1987); *Int’l Air Indus. v. Am. Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975).

27. See A.B.A. ANTITRUST SEC., SAMPLE JURY INSTRUCTIONS IN CIVIL ANTITRUST CASES C-50 to C-55 (3d. ed. 1999). Of course these elements implicate other subsidiary issues as well, including relevant market definition, monopoly power, and ease of entry.

28. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 229 (1993).

IV. 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.²⁹ What economics in the post-Chicago School era has rediscovered is that while predatory pricing by monopolists may be an unlikely and/or unsuccessful strategy, other types of nonprice 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.”³⁰

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 cost that the dominant firm is able to inflict on its rivals as a “tax” or “penalty,”³¹ which is an amount of money that the nondominant firm must pay to sell its products. Most often the tax is in the form of an additional discount that the nondominant firm must offer to buyers in order to compensate them for switching some of their purchases from the dominant firm to the nondominant firm. Often this tax is substantial, so that the nondominant firm cannot obtain additional sales by giving a *slightly* better price; it 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. Consider the following hypothetical situation:³²

Assume a market for widgets, which is a differentiated and intermediate product. There is a dominant manufacturer and a single and smaller competitor. Assume that, due to a first mover advantage or some other factor, the dominant firm is so well established

29. See, e.g., Philippe Aghion & Patrick Bolton, *Contracts as a Barrier to Entry*, AM. ECON. REV., June 1987, at 388; Joseph F. Brodley & Ching-to Albert Ma, *Contract Penalties, Monopolizing Strategies, and Antitrust Policy*, 45 STAN. L. REV. 1161 (1993); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1986); Thomas G. Krattenmaker & Steven C. Salop, *Competition and Cooperation in the Market for Exclusionary Rights*, AM. ECON. REV., May 1986, at 109; Steven C. Salop & David T. Scheffman, *Raising Rivals' Costs*, AM. ECON. REV., May 1983, at 267.

30. Mike France, *Are Corporate Predators on the Loose?*, BUS. WK., Feb. 23, 1998, at 125 (quoting Frederick Warren-Boulton). See also Kenneth Baseman et al., *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) (describing Microsoft's strategies to maintain monopoly power).

31. Richard M. Steuer, *Discounts and Exclusive Dealing*, 7 ANTITRUST 28 (1993); 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, *Anticompetitive Aspects of Exclusive Dealing and Related Practices* (Apr. 15, 1999) (unpublished paper delivered at ABA Antitrust Section Conference).

32. This example is borrowed from Willard Tom, see *supra* note 31, but is largely based on the facts of *Concord Boat Corp. v. Brunswick Corp.*, 318 F.3d 1156 (8th Cir. 2003).

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% of their business.³³ Now assume that the dominant firm charges a normal price to customers that purchase up to 69% of their widget requirements from the dominant firm, but offers a 6% discount to customers that purchase 70% or more of their widgets from the dominant firm, with the discount being given back to the first unit purchased. Viewed simplistically, this just looks like just a 6% 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%. 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%.

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 prices could be eliminated.

Table 1 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% of its sales, and that Brand A sets a market share discount of 6% if the buyer purchases 70% of its requirements from Brand A. Correctly viewed, the 6% discount is not the roughly \$7 per unit it appears, but rather it is a \$49 discount for the incremental unit number seven.

33. The fixed demand of 60% may be due to several factors: 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.

Table 1: 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.		

Table 1 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.

An example of this type of discount program was litigated in *SmithKline Corp. v. Eli Lilly & Co.*³⁴ In that case drug manufacturer SmithKline sued Eli Lilly, a competing manufacturer, claiming that Lilly's marketing program for its cephalosporin antibiotic products constituted a monopolistic scheme in violation of section 2 of the Sherman Act, a tying arrangement in violation of sections 1 and 3 of the Sherman Act and section 3 of the Clayton Act, and abuse and misuse of patents in violation of sections 1, 2, and 3 of the Sherman Act. After a bench trial, the district court entered judgment for Eli Lilly on its monopolization claim, but rejected its other claims.³⁵ The Third Circuit affirmed.³⁶

At issue in this case was Lilly's hospital marketing program for its five brand name cephalosporin oral and injectable drug products, the most popular of which were sold under the brand names Keflin (injectable) and Keflex (oral). Lilly held a patent on Keflin and Keflex and had a "legal monopoly" in those two markets, but faced competition on another injectable cephalosporin product, Kefzol, from SmithKline's Ancef.

In April 1975, Lilly revised its cephalosporin discount program (Revised Cephalosporin (CSP)) to increase the offered rebates and, more importantly, to add an additional 3% bonus rebate, "based on the purchases of established minimum quantities of any three of Lilly's five cephalosporin products."³⁷ Two of Lilly's five products had de minimis sales, therefore the court found that the effect of the revised discount program was "to combine, for purposes of pricing, hospital purchases of Keflex and Keflin with those of Kefzol."³⁸ Although hospitals were free to purchase Keflex and Keflin from Lilly and Ancef from SmithKline, because Lilly's patent protected Keflex and Keflin held a combined 75% market share, the Third Circuit found that "the practical effect of

34. *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978).

35. *SmithKline Corp. v. Eli Lilly & Co.*, 427 F. Supp. 1089 (E.D. Pa. 1976).

36. *SmithKline*, 575 F.2d at 1056.

37. *Id.* at 1060.

38. *Id.* at 1061.

[such a] decision would be to deny the Ancef purchaser the 3% bonus rebate on all its cephalosporin purchases.”³⁹

In order to meet the economic incentive of Lilly’s new bonus rebate, SmithKline not only had to compete on price with Lilly’s Kefzol, but also had to make up the bonus rebate for Keflex and Keflin foregone by purchasers due to their selection of Ancef. Stated differently, in order to offer a rebate of the same net dollar amount as Lilly’s new 3% bonus rebate, because of Lilly’s volume advantage SmithKline had to offer Ancef purchasers rebates of 16% to 35%, depending on the size of the hospital purchaser.

After concluding that the district court had properly defined the relevant market as the nonprofit hospital market for cephalosporin antibiotics, the Third Circuit reviewed whether Lilly possessed monopoly power and, if so, whether it unlawfully acquired or maintained that power. The court concluded that Lilly was a monopolist, based on its high market share (89.4% even after competitive products appeared on the market) and its “fair measure of success” in insulating Kefzol from what it characterized as “true price competition” by means of its revised discount program.⁴⁰

The court further concluded that Lilly willfully acquired and maintained monopoly power “by linking products on which Lilly faced no competition[,] Keflin and Keflex[,] with a competitive product, Kefzol.”⁴¹ The result enabled Lilly “to sell all three products on a non-competitive basis in what would have otherwise been a competitive market for Ancef and Kefzol,” because the Revised CSP Program forced SmithKline to pay rebates on one product equal to rebates paid by Lilly based on the volume of sales of three of its products. Expert evidence at trial characterized SmithKline’s prospects for continuing under such conditions in this market as poor. Thus, the court concluded that although Lilly had been a “legal monopolist when it was engaged in the manufacture and sale of its original patented products,”⁴² Lilly’s status changed when it implemented the Revised CSP Program, the purpose and effect of which was to associate Lilly’s legal monopoly with an “illegal activity that directly affected the price, supply, and demand of Kefzol and Ancef.”⁴³

In a similar case, *Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc.*, Ortho, a seller of blood screening tests, sued the dominant manufacturer Abbott.⁴⁴ It claimed that Abbott’s contract with an important group purchasing organization foreclosed competition in violation of sections 1 and 2 of the Sherman Act, section 3 of the Clayton Act, and New York’s Donnelly Act.⁴⁵ The district court granted Abbott’s summary judgment motions as to all claims except Ortho’s claim that Abbott tied the sale of certain of its blood assays to the availability of its separate data management system product.⁴⁶

The relevant products in the case were five blood screening tests (or assays) used to test blood for the presence of viruses such as hepatitis and HIV.⁴⁷ The five assays

39. *Id.* at 1061-62.

40. *Id.* at 1065.

41. *SmithKline*, 575 F.2d at 1065.

42. *Id.* at 1056.

43. *Id.*

44. *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996).

45. *Id.*

46. *Id.*

47. *Id.* at 457.

performed separate functions and were not interchangeable.⁴⁸ Also at issue was the data management system (DMS) product used to “collate and coordinate” the results of blood screening tests performed by the blood donor centers (BDCs), which collect whole blood from donors.⁴⁹ Other users of assays included hospitals, plasma centers, which collected plasma as opposed to whole blood, and laboratories.⁵⁰

At the time of the lawsuit, “Abbott was the only company that made all five of the blood assays.”⁵¹ Abbott accounted for over 70% of the sales of four of the five assays,⁵² with a figure of 91% for the HTLV assay and, by alternate measures, 77% or 86% of the HIV-1/2 assay.⁵³ Ortho had meaningful sales of three assays, HBsAg, Anti-core and HCV. There were no other significant competitors.⁵⁴

At issue in this case was a three-year contract between Abbott and the Council of Community Blood Centers (CCBC), which engages in joint purchasing activities on behalf of its participating members.⁵⁵ CCBC members and the American Red Cross (the largest BDC operator) together collected 85% to 90% of the blood gathered by BDCs.⁵⁶ Pursuant to the contract with Abbott, CCBC members were “entitled to advantageous pricing if they purchased a package of four or five” assays (with or without Abbott’s DMS) from Abbott.⁵⁷ Although the terms of the contract were available to CCBC members, they were not obligated to purchase assays from Abbott until they signed individual contracts with Abbott, specifying delivery schedules and guaranteeing purchase volumes.⁵⁸ Thus, the “master contract did not preclude [a] CCBC member from entering into [agreements] with Ortho, at least until [the member] committed [itself] to Abbott by individual contract.”⁵⁹

Ortho claimed that because “BDCs needed all five” assays, most felt they needed to purchase at least the two most dominant Abbott products—HIV-1/2 (86% share) and HTLV (91% share)—from Abbott, which Ortho did not sell.⁶⁰ Ortho alleged that Abbott’s unbundled price for these two products over the package prices to CCBC members included “penalties” for buying other tests from other suppliers. Thus, according to Ortho, the financial penalties associated with purchasing any of the other three tests from Ortho were “so severe that the option . . . was virtually illusory.”⁶¹

Although Ortho was able to retain some business of CCBC customers by making substantial price concessions, subsequent to the execution of the CCBC contract it “lost a significant volume of sales that [it claimed] it otherwise would have made to CCBC

48. *Id.*

49. *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 455.

50. *Id.* at 457.

51. *Id.*

52. *Id.*

53. *Id.*

54. *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 459.

55. *Id.* at 459-60.

56. *Id.* at 457.

57. *Id.*

58. *Id.* at 460-61.

59. *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 460.

60. *Id.* at 461.

61. *Id.*

customers.”⁶² Nonetheless, in contrast to *SmithKline v. Eli Lilly*, the court found it significant that “Ortho’s blood assay business . . . remain[ed] profitable,” and that it still had the flexibility to absorb substantial additional price cuts on at least its HCV product.⁶³

The court identified the key allegation underlying each of Ortho’s three section 2 claims as follows: “Ortho insists that the package pricing in the [CCBC] contract improperly uses Abbott’s alleged dominance in markets for some of the five assays to gain an [improper] advantage over Ortho in the other assays.”⁶⁴ For its part, Abbott claimed summary judgment was appropriate because (1) it lacked monopoly power or the dangerous probability of acquiring it in any relevant market; (2) its pricing was above its average variable cost and therefore was nothing more than legitimate competition that benefited consumers; and (3) there was no harm to competition.⁶⁵

After finding that there was a triable issue as to whether Abbott possessed market power in the relevant assay markets, the court explained that Ortho’s section 2 claims nevertheless required proof of “predatory or anticompetitive conduct or an inappropriate use of monopoly power” by Abbott.⁶⁶ The court noted that if Abbott’s pricing “was legitimately competitive, [then] all three [section 2 claims] fail.”⁶⁷

In addressing these issues, the court first acknowledged that price cutting is generally pro-competitive and that rules which seek to thwart undesirable pricing behavior must be carefully drawn to avoid discouraging legitimate pricing behavior.⁶⁸ The court further acknowledged the Supreme Court’s holding in *Brooke Group* that a plaintiff seeking to succeed on a claim that a defendant caused “competitive injury” through “low prices must prove that the prices complained of are below an appropriate measure of [that defendant’s] costs.”⁶⁹ The court, however, distinguished *Brooke Group*, noting that Abbott’s challenged pricing involved not a single product but “bundled pricing of a package of complimentary products, in some of which the defendant has market power, as well as the unbundled prices of the components of the package.”⁷⁰ The court therefore rejected Abbott’s contention that it could not have violated section 2 because each component of its package was priced above average variable cost, finding instead that Abbott’s pricing could be actionable if it could have driven a more efficient competitor from the market.

The court summarized its analysis and holding as follows:

[In] a case . . . in which a monopolist (1) faces competition on only part of a complementary group of products, (2) offers the products both as a package and individually, and (3) effectively forces its competitors to absorb the differential between the bundled and unbundled prices of the product in which the monopolist has market power[, a plaintiff] must

62. *Id.* at 462.

63. *Id.* at 469.

64. *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 463.

65. *Id.*

66. *Id.* at 465.

67. *Id.* at 471.

68. *Id.* at 465-66.

69. *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 466.

70. *Id.*

allege and prove either that (a) the monopolist has priced below its average variable cost or (b) the plaintiff is at least as efficient a producer of the competitive product as the defendant, but that the defendant's pricing makes it unprofitable for the plaintiff to continue to produce. Any other rule would entail too substantial a risk that the antitrust laws would be used to protect an inefficient competitor against price competition that would afford substantial benefits to consumers.⁷¹

On the facts before it, the court found it "highly significant" that however deep Abbott's price cuts were, Abbott priced its product not only above Abbott's average variable costs, but also above Ortho's costs.⁷² Abbott's package pricing therefore left Ortho with the ability to sell its product at a profit, albeit a reduced one. The court thus concluded that Abbott's pricing was "legitimately competitive."⁷³

Ortho also alleged that the package pricing implicitly tied those assays in which Abbott lacked market power to either or both (1) the assays where Abbott exercised market power and (2) Abbott's DMS.⁷⁴ On the former claim, because there was no claim of an explicit tie between the products the court found that Ortho could succeed only if it proved that Abbott's package pricing made purchase of the tying and tied products together "the only viable economic option."⁷⁵ The court explained that the sale of products as part of a package at a discount would not alone be sufficient to establish the required tie.⁷⁶ The court granted summary judgment to Abbott, finding that the prices of the unbundled monopoly products were not so high as to make their purchase as part of the package the only viable alternative.⁷⁷

On the DMS tying claim, the court rejected Abbott's summary judgment argument, finding genuine issues of material fact concerning whether Abbott possessed market power in the tying DMS product market and whether Abbott in fact required CCBC members to purchase a package of four or more assays in order to buy its DMS product.⁷⁸

V. MICROSOFT CASES

The conduct of Microsoft Corporation (Microsoft), challenged by the Department of Justice (DOJ) in two separate civil actions, is another well-known example of the new theories of predation. In *Microsoft I*, 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.⁷⁹ Microsoft required PC makers to pay 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 found in *United*

71. *Id.* at 469-70 (citation omitted).

72. *Id.* at 469.

73. *Id.* at 471.

74. *Ortho Diagnostic Sys., Inc.*, 920 F. Supp. at 472.

75. *Id.* at 471.

76. *Id.*

77. *Id.* at 472.

78. *Id.* at 455.

79. *Microsoft I*, 59 Fed. Reg. 42,845.

Shoe.⁸⁰

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 in order to compete with other PC makers who agreed to the per processor license, most PC makers ended up agreeing to pay for 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 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. This would have been impossible, especially for firms operating below minimum efficient scale.

Microsoft I was settled by a consent decree that prohibited the use of such license agreements.⁸¹ 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.

In addition, of course, Microsoft had begun using additional business strategies to extend its dominance. These strategies were challenged by the DOJ in *Microsoft III*.⁸² The DOJ challenged Microsoft’s practices under four legal theories: (1) exclusive dealing arrangements with original equipment manufacturers (OEMs), Internet access providers (IAPs), software vendors, and Internet content providers (ICPs); (2) tying of the Internet Explorer (IE) browser to the Windows operating system; (3) monopoly maintenance in the operating system market; and (4) attempted monopolization of the Internet browser market.⁸³ The district court ruled against Microsoft on all but one count, and required Microsoft to divest itself of IE. The D.C. Circuit affirmed in part and reversed in part, which led the parties to reach a consent agreement that was much less onerous than the district court’s remedy.⁸⁴

The DOJ’s claim largely revolved around the interrelationship between a computer’s operating system, the platform that runs various applications, and Internet browsers, the software used to read material on the World Wide Web. Both product markets display positive network externalities. That is to say that the value of an individual browser or operating system increases as more customers purchase it and more designers design applications for it.

The case attacked Microsoft practices that furthered its monopoly in the operating system market or attempted to leverage that monopoly into the browser market. Central to the DOJ’s case was the potential of Internet browsers such as Netscape Navigator to evolve into operating systems and unravel Microsoft’s monopoly in the operating system market. The DOJ attacked practices that locked users into Microsoft’s IE browser at the

80. *United Shoe Mach. Corp. v. United States*, 258 U.S. 451, 457 (1922).

81. *Microsoft I*, 59 Fed. Reg. 42,845.

82. *Microsoft II* involved the enforcement of the consent decree in *Microsoft I*.

83. *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 39-40 (D.D.C. 2000).

84. *United States v. Microsoft Corp.*, 253 F.3d 34, 46 (D.C. Cir. 2001) [hereinafter *Microsoft III*].

expense of competitors. Because of the potential for browsers to act as platforms, Microsoft's attempts to limit browser competition had a spillover effect, preserving Microsoft's operating system monopoly.

On the operating system monopolization claim, the district court defined the relevant market as "the licensing of all Intel-compatible PC operating systems worldwide."⁸⁵ The district court found that several of Microsoft's practices within this market violated section 2, as they were aimed at mitigating the threat posed to its operating system monopoly by Netscape Navigator and Java. Specifically, the court condemned the following Microsoft practices: (1) its licensing agreements with computer manufacturers OEMs; (2) its integration of the IE browser into the Windows operating system; (3) its agreements with IAPs, such as America Online; (4) its agreements with internet content providers (ICPs), the creators of individual websites; and (5) its conduct towards Java, a set of technologies that could potentially compete with Windows.⁸⁶

The district court concluded that several of Microsoft's licensing agreements with OEMs were anticompetitive. First, it condemned Microsoft's prohibition on manufacturers removing IE icons from the Windows desktop because it prevented computer manufacturers from installing competing browsers.⁸⁷ This had the effect of eliminating competition from companies such as Netscape, whose browsers could evolve to compete with Windows in the operating system market. Second, it ruled that Microsoft's prohibitions on OEMs altering the initial "boot sequence," the series of screens a user sees the first time she starts her computer, were anticompetitive because they prevented computer manufacturers from promoting non-Microsoft browsers on their machines.⁸⁸ Finally, the court concluded that similar restrictions on manufacturers altering the appearance of the desktop prevented competing browsers from gaining a foothold into users of the Windows operating system.⁸⁹

The D.C. Circuit upheld the district court's market definition and its finding that Microsoft possessed market power in that market. The court affirmed nearly all of the district court's conclusions regarding the OEM licenses.⁹⁰ Because of the network effects inherent in the browser market, a browser manufacturer required a "critical mass" of software developers writing to its platform in order to attract users.⁹¹ "Therefore, Microsoft's efforts to gain market share in one market (browsers) served to meet the threat to Microsoft's monopoly in another market (operating systems). . . ."⁹²

The court held that Microsoft's prohibitions on removing the IE icon or altering the desktop was anticompetitive because they essentially prevented OEMs from placing multiple browsers on their desktops. The court credited the district court's finding that the installation of multiple browsers was not feasible because it would lead to consumer confusion and increased support calls. The court similarly affirmed the district court's ruling that preventing OEMs from altering the boot sequence prevented the OEMs from

85. *United States v. Microsoft Corp.*, 87 F. Supp. 2d at 36.

86. *Id.* at 39-46.

87. *Id.* at 50.

88. *Id.* at 41.

89. *Id.*

90. *Microsoft III*, 253 F.3d 34, 64 (D.C. Cir. 2001).

91. *Id.*

92. *Id.* at 60.

offering Internet service to consumers that did not employ IE as its browser, thereby harming competition in the browser market.⁹³

The court rejected two of Microsoft's proffered pro-competitive justifications for its conduct.⁹⁴ One of these justifications was that, while Microsoft may have foreclosed some of Netscape's distribution channels, Netscape had alternative channels available. Similar to the Third Circuit in *Dentsply*,⁹⁵ discussed at length below, the court held that it was enough for a section 2 violation that a monopolist foreclose the most cost-effective channels of distribution, even if alternative means were available.

Regarding the restrictions with IAPs, the government originally attacked Microsoft's practice of providing large IAPs, such as America Online, free copies of IE and an access kit for IE, or paying the IAPs to accept IE as their browser. It also claimed that Microsoft's deals with IAPs were anticompetitive. These deals placed the IAP on the Windows desktop on the condition that the IAP promote IE exclusively and limit the percentage of shipments of internet access software using Netscape Navigator to under 25%.

The district court found Microsoft liable on all issues.⁹⁶ Its analysis most closely resembled that of a section 1 exclusive dealing claim, as it concluded that Microsoft's restrictions were unjustified because they "closed off a substantial amount of distribution that would not have constituted a free ride to Navigator."⁹⁷ The court of appeals summarily rejected the pricing-based monopolization claims, holding that "[t]he rare case of price predation aside, the antitrust laws do not condemn even a monopolist for offering its product at an attractive price."⁹⁸ In this way, the D.C. Circuit's analysis differed from *LePage's Inc. v. 3M*, which held that below-cost pricing was not necessary for a pricing-based monopolization claim.⁹⁹

On the 25% restrictions, the D.C. Circuit affirmed liability after a more thorough analysis. It framed IAPs as distribution channels for browsers and noted that, through its contracts with IAPs, Microsoft foreclosed a significant share of the IAP channel from Netscape and other competitors. This, the court stated, kept Netscape below the critical level necessary for it to attract developers to write programs for its browser.¹⁰⁰ Because keeping a competitor such as Netscape under its critical mass of users effectively forecloses those competitors, especially in a network market such as the browser market, the D.C. Circuit affirmed.¹⁰¹

The DOJ also challenged Microsoft's practices towards software and website developers, and Apple, which was both an OEM and a software developer. Microsoft gave those parties preferential treatment, contingent on them making IE the default browser in their software products. The district court found anticompetitive effects in

93. *Id.* at 61, 63.

94. *Id.* at 72.

95. *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181 (3d Cir. 2005).

96. *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 35 (D.D.C. 2000).

97. *Id.* at 42.

98. *Microsoft III*, 253 F. 3d at 68.

99. *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003).

100. *Microsoft III*, 253 F.3d at 71.

101. *Id.* at 71.

Microsoft's conduct towards software developers and Apple.¹⁰² The circuit court affirmed the conclusion that the deals harmed competition.¹⁰³ Thus, although the software developer and Apple channels were relatively small, they were significant in light of the fact that other significant avenues were foreclosed. As Microsoft offered no pro-competitive justification for these practices, the D.C. Circuit affirmed liability.¹⁰⁴

The final aspect of monopolization the DOJ and the courts examined was Microsoft's attempts to eliminate Sun Microsystem's Java applications from the market. Java was a set of technologies that posed a threat to Microsoft because it had the potential to serve as an alternative platform to Windows. Microsoft had developed its own Java Virtual Machine (JVM), an application that translates Java code into instructions for the operating system, to compete with Sun's. The two firms' JVMs were incompatible. Similar to *Carter Carburetor*¹⁰⁵ 60 years earlier, Microsoft offered favorable deals to software developers and other distributors on the condition that those distributors use Microsoft's JVM. In addition, the DOJ alleged, and the district court found, that Microsoft designed its Java software to deceive developers into thinking that the Microsoft and Sun JVMs were interoperable, when in reality programs designed for Microsoft's JVM would not operate on Sun's.¹⁰⁶ This, the D.C. Circuit affirmed, "served to protect [Microsoft's] monopoly of the operating system,"¹⁰⁷ and served no pro-competitive purpose, and was therefore illegal under section 2 of the Sherman Act.

The government also sued on the basis of Microsoft's alleged attempted monopolization of the Internet browser market. Because operating systems and Internet browsers are at least potential competitors, it is not surprising that the district court concluded that section 2 operating system monopolization liability "warranted additional liability as an illegal attempt to amass monopoly power in 'the browser market.'"¹⁰⁸ The D.C. Circuit reversed on relevant market grounds, which are somewhat independent of Microsoft's conduct.¹⁰⁹

Finally, the courts addressed Microsoft's integration of Windows and IE under another antitrust theory, tying. The DOJ argued for per se liability for the contractual and technical tying arrangements, and the district court agreed, under the *Jefferson Parish* standard for per se tying liability.¹¹⁰ The court of appeals reversed the district court's per se conclusion on the "separate products" element of the *Jefferson Parish* test.¹¹¹ The court accepted Microsoft's argument that per se liability was inappropriate because there was little judicial experience with the technological integration of application software with platform software from which to adjudge Microsoft's arrangements unlawful per se.¹¹² It was also persuaded that the single products test is inappropriate in markets such

102. *Microsoft*, 87 F. Supp. 2d at 30.

103. *Microsoft III*, 253 F.3d at 34.

104. *Id.*

105. *Carter Carburetor Corp. v. Fed. Trade Comm'n*, 112 F.2d 722 (8th Cir. 1940).

106. *Microsoft*, 87 F. Supp. 2d at 30.

107. *Microsoft III*, 253 F.3d at 77.

108. *Id.* at 81.

109. *Id.* at 78.

110. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984).

111. *Microsoft III*, 253 F.3d at 85.

112. *Id.* at 84.

as software, in which technological advances dictate integration of products that were once separate.¹¹³ For this reason, the court expressed concern that the test could condemn the tying of once separate products, even if the tie is efficient and demanded by consumers.¹¹⁴

Although the D.C. Circuit accepted the government's allegations of anticompetitive effects arising out of a monopolist's exclusive dealing arrangements, it took a more skeptical view of pricing related theories of predation. Similarly to the Third Circuit in *Dentsply*, the D.C. Circuit analyzed the competitive effects of Microsoft's exclusive dealing in light of market realities. Under this analysis, a monopolist can be liable for exclusive dealing, notwithstanding the fact that "second-best" distribution channels exist.¹¹⁵ With regards to pricing claims, however, the court upheld the general right of a firm to offer its products at attractive prices, regardless of that firm's intentions or its monopoly status. But interestingly, when those attractive prices had exclusionary "strings" attached to them, the court was willing to condemn those practices.¹¹⁶ As such, the *Microsoft* holdings regarding pricing are not inconsistent with recent theories of predation, which condemn a monopolist's practices of making rebates or deals contingent on other purchases by the customer.

VI. *CONCORD BOAT*

In *Concord Boat*,¹¹⁷ the case in which I was lead trial counsel, the plaintiffs were twenty-one firms that manufactured pleasure boats powered by stern drive marine engines and a buying group, Independent Boat Builders, Inc. The defendant was Brunswick Corporation, which was 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,¹¹⁸ as well as the plaintiffs' largest competitor in the boat market. Moreover, the relevant engine market (stern drive engines sold in North America) was rather small in terms of the total numbers of units (about 100,000 per year), and the minimum efficient scale was between 25% and 40% of the market. The market has substantial entry barriers and exhibits certain network effects. These large and complex engines are both sold and serviced through networks of both boat builders and marine dealers. Thus, the structure and characteristics of the relevant market were conducive to the exercise of market power by a dominant firm.

Beginning in the latter part of the 1980s, Brunswick began using "market share"

113. *Id.* at 92-93.

114. *Id.* at 89.

115. *Id.* at 71.

116. See *Microsoft III*, 253 F.3d at 67-68, 70-71 (allowing Microsoft to offer IE and IE access kit at little or no cost, while condemning Microsoft's provision of support services, conditioned on the IAP's promotion of the IE browser).

117. *Concord Boat Corp. v. Brunswick Corp.*, 21 F. Supp. 2d 923 (E.D. Ark. 1998), *rev'd*, 207 F.3d 1039 (8th Cir. 2000), *cert. denied*, 531 U.S. 979 (2000).

118. The average cost of an engine is approximately 50% of the cost of making a boat.

agreements in its marketing of stern drive engines.¹¹⁹ Although the terms varied slightly over the years, generally the structure required that in order to achieve the highest rebates and/or discounts on its engine purchases, the boat builder had to agree to purchase at least 80% of its engines from Brunswick. During certain periods, the boat builder had to commit to the 80% level for a period of three years in order to receive 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.”¹²⁰ The dominant share Brunswick enjoyed in the relevant engine market enabled it to deprive its rivals of the only business strategy that could work: small increases in purchases at many boat builders. Boat builders were faced—at least at the 80% market share level—with the equivalent of an “all or nothing” choice like the computer OEM’s faced with Microsoft’s per processor license fee.¹²¹ Since the minimum efficient scale 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 boat builders 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 boat builders over \$133 million in damages.¹²²

As noted, in March 2000 the Eighth Circuit reversed the jury’s verdict and entered judgment for defendant Brunswick.¹²³ In a decision, in my view, that ignored applicable antitrust precedent and exhibited inattention to the record of a ten-week trial, a panel of the court concluded that the challenged conduct was not anticompetitive as a matter of law.¹²⁴ 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.¹²⁵

In discussing Brunswick’s discount programs, the court emphasized the fact that builders could buy 40% of their engines from other manufacturers and still receive a discount from Brunswick, and that none of the programs or contracts obligated boat builders and dealers to purchase engines from Brunswick, *that is*, they simply could have foregone these programs and purchased engines from other manufacturers.¹²⁶

In response to the launch of a successful new product (the Cobra) by Brunswick’s largest domestic competitor (Outboard Marine Corporation), which reduced Brunswick’s market share to 50%, Brunswick integrated vertically in 1986 and purchased two of the largest U.S. boat builders. Further, in 1989, Outboard Marine was forced to recall all of its Cobra engines due to a shift cable defect. This recall and other missteps by certain competitors, as well as the withdrawal from the market by certain other competitors, improved Brunswick’s market position in the early 1990s. Between 1986 and 1997, the price for Brunswick’s engines fluctuated between \$4775 and \$4984.

Applying a rule of reason analysis to plaintiffs’ section 1 claims, the Eighth Circuit

119. *Concord Boat Corp.*, 21 F. Supp. 2d at 928.

120. *Id.* at 931.

121. *Microsoft III*, 253 F.3d at 34.

122. *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1043-44 (8th Cir. 2000).

123. *Id.* at 1044.

124. *Id.*

125. *Id.* at 1048.

126. *Id.* at 1063.

determined that the reasonableness of Brunswick's programs, which at most were de facto exclusive dealing arrangements, depended on the extent to which the arrangements foreclosed competition in the relevant market, their duration, and the height of entry barriers.¹²⁷ The court found plaintiffs' evidence lacking on each point. The court first found that plaintiffs "failed to produce sufficient evidence to demonstrate that Brunswick had foreclosed a substantial share of the stern drive engine market through anticompetitive conduct."¹²⁸ The court next found that plaintiffs failed to demonstrate that Brunswick's discount programs were in any way exclusive.¹²⁹ Boat builders did not have to commit to Brunswick for any particular period of time and could walk away from the discounts at their pleasure.¹³⁰ Further, there was evidence that boat builders in fact had switched their purchases from Brunswick when offered superior discounts by Brunswick's competitors.¹³¹

The court also found that barriers to entry were lacking.¹³² The court explained that Brunswick's prices were substantially above cost and left ample room for new firms to enter the market and draw customers from Brunswick with superior discounts.¹³³ The court also relied on the fact that there had been recent entry by competitors.¹³⁴ For these reasons, the court concluded that plaintiffs failed to show that Brunswick's programs could have caused injury or that they were a material cause of the claimed harm.¹³⁵

With respect to plaintiffs' section 2 claims, the court found that the challenged conduct, price cutting in response to competitive pressures, was lawful.¹³⁶ The court read Supreme Court precedent, including *Brooke Group*¹³⁷ and *Matsushita*,¹³⁸ as illustrating "the general rule that above cost discounting is not anticompetitive."¹³⁹ Thus, because there was no allegation that Brunswick's discounts were below any measure of cost, the court rejected plaintiffs' argument that Brunswick's marketing programs, combined with its acquisitions, allowed it to avoid competition on the merits.¹⁴⁰

In making this determination, the court distinguished cases such as *SmithKline*¹⁴¹ and *Ortho Diagnostics*¹⁴² that rejected the argument that any pricing practice that leads to above-cost pricing is per se legal under the antitrust laws, by explaining that such cases involved either tying or bundling, neither of which was present in the case before it.¹⁴³

The court concluded that Brunswick achieved its market dominance through

127. *Concord Boat Corp.*, 207 F.3d at 1059.

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. *Concord Boat Corp.*, 207 F.3d at 1059.

133. *Id.*

134. *Id.*

135. *Id.* at 1060.

136. *Id.* at 1061.

137. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993).

138. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).

139. *Concord Boat Corp.*, 207 F.3d at 1061.

140. *Id.* at 1062.

141. *SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978).

142. *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455 (S.D.N.Y. 1996).

143. *Concord Boat Corp.*, 207 F.3d at 1062.

aggressive discounts, which was competition on the merits.¹⁴⁴ Boat builders were free to take or leave the discount programs, and the evidence showed they did so when competitors offered better discounts. Moreover, boat builders were not required to refrain from buying from Brunswick's competitors in order to receive discounts, and could receive at least some discounts by purchasing only 60% of their requirements from Brunswick. Thus, the court found no basis for plaintiffs' claim that Brunswick's discounts created "golden handcuffs" and other barriers to entry.¹⁴⁵

VII. *LE PAGE'S V. 3M*

Although *Concord Boat* was one of the first cases to use these emerging theories to get to trial, it was followed by the trial in *LePage's, Inc. v. 3M*,¹⁴⁶ in which the jury also returned a multi-million dollar verdict for plaintiffs. The defendant 3M enjoyed a dominant market share (90%) in the market for invisible and transparent tape.¹⁴⁷ It faced competition from LePage's in the private label segment of that market.¹⁴⁸ Essentially, LePage's made private label tape for retailers such as K-Mart, Wal-Mart, and others.¹⁴⁹

3M adopted a marketing strategy referred to as "bundled rebates."¹⁵⁰ That is, 3M offered its most attractive rebates and discounts to large retailers *only* if they achieved certain aggressive sales targets for several of 3M's other products.¹⁵¹ In this case, 3M bundled both tape and other desirable products like Post-It notes.¹⁵² 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. On October 18, 1999, the jury returned a verdict for the plaintiff, finding that the defendant's conduct violated section 2 of the Sherman Act and awarding damages (before trebling) of almost \$23 million.¹⁵³ On appeal, the Third Circuit initially reversed the judgment in favor of LePage's on its monopolization claim, but later vacated that decision to rehear the case en banc.¹⁵⁴ The full panel of the Third Circuit affirmed the district court's judgment.¹⁵⁵

3M had been the dominant manufacturer in the U.S. transparent tape market for some time, with a "market share above 90% until the early 1990s."¹⁵⁶ In 1980, LePage's began selling "second brand" and private label transparent tape, *i.e.*, tape sold under the

144. *Id.* at 1061.

145. *Id.* at 1063.

146. *See* *Le Page's Inc. v. 3M*, No. Civ. A. 97-3983, 2000 WL 280350 (E.D. Pa. Mar. 2000), *aff'd*, 324 F.3d 141 (3d Cir. 2003), *cert. denied*, 542 U.S. 953 (2004).

147. *LePage's Inc. v. 3M*, 324 F.3d 141, 144 (3d Cir. 2003).

148. *Id.*

149. *Id.*

150. *Id.* at 145.

151. *Id.*

152. *LePage's Inc.*, 324 F.3d at 145.

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.* at 144.

retailer's name rather than under the name of the manufacturer."¹⁵⁷ Private label tape sold at a discount to branded tape, and by 1992, LePage's was selling 88% of the private label tape in the United States. Private label tape, however, "represented a small portion of the transparent tape market."¹⁵⁸

Various market factors, including the growth of office superstores and mass merchandisers and their desire to use their "brand name" to sell stationery products, including transparent tape, led to a shift of some tape sales from branded to private label tape.¹⁵⁹ In response, "3M . . . entered the private label business during the early 1990s and sold its own second brand under the name "Highland."¹⁶⁰ 3M also began to offer multi-tiered bundled rebates, which provided "higher rebates when customers purchased products in a number of 3M's different product lines."¹⁶¹ The bundled rebates were structured so that the discounts were "conditioned on purchases spanning six of 3M's diverse product lines."¹⁶² The programs set target growth rates in each product line, and "[t]he size of the rebate was linked to the number of product lines in which targets were met, and the number of targets met by the buyer determined the rebate it would receive on all of its purchases."¹⁶³ Failure to meet the target for any one product caused the customer to lose the rebate across the line.¹⁶⁴ "This created a substantial incentive for each customer to meet the targets across all product lines to maximize its rebates," which were "considerable."¹⁶⁵ 3M also entered into contracts with customers that either expressly or effectively (based on the structure of the discounts) required the customer to deal exclusively with 3M.¹⁶⁶ The court found that "3M offered many of LePage's major customers substantial rebates to induce them to eliminate or reduce their purchases of tape from LePage's."¹⁶⁷ 3M did not, however, sell any of its transparent tape below cost.¹⁶⁸

3M conceded that it possessed monopoly power in the U.S. transparent tape market, thus the primary issue the Court addressed was "whether 3M took steps to maintain that power in a manner that violated §2 of the Sherman Act."¹⁶⁹ In addressing this issue, the court first addressed 3M's primary contention on appeal, namely, that in accordance with the Supreme Court's decision in *Brooke Group*, 3M's conduct "was legal as a matter of law because it never priced its transparent tape below its cost."¹⁷⁰ The Third Circuit surveyed Supreme Court section 2 precedent, including *Brooke Group*, and determined that "[a]ssuming *arguendo* that *Brooke Group* should be read for the proposition that a company's pricing action is legal if its prices are not below its costs, nothing in the

157. *LePage's Inc.*, 324 F.3d at 144.

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.* at 145.

162. *LePage's Inc.*, 324 F.3d at 154.

163. *Id.*

164. *Id.* at 144.

165. *Id.* at 154.

166. *Id.* at 157.

167. *LePage's Inc.*, 324 F.3d at 154.

168. *Id.* at 173.

169. *Id.* at 146.

170. *Id.* at 147.

decision suggests that its discussion of the issue is applicable to a monopolist with its unconstrained market power.”¹⁷¹ The court explained that, in this case, 3M was a monopolist, and “a monopolist is not free to take certain actions that a company in a competitive (or even oligopolistic) market may take, because there is no market constraint on a monopolist’s behavior.”¹⁷² The court further distinguished the facts of this case from *Brooke Group* by noting that LePage’s, unlike the plaintiff in *Brooke Group*, had not alleged a section 2 violation predicated on predatory pricing.¹⁷³ The court concluded that the *Brooke Group* decision did not “dilute[] the [Supreme] Court’s consistent holdings that a monopolist will be found to violate §2 of the Sherman Act if it engages in exclusionary or predatory conduct without a valid business justification.”¹⁷⁴ Here, the court found 3M had done exactly that. The court determined that “3M sought to meet the competition that LePage’s threatened by exclusionary conduct that consisted of rebate programs and exclusive dealing arrangements designed to drive LePage’s and any other viable competitor from the transparent tape market.”¹⁷⁵

In its analysis of the bundled rebates offered by 3M, the court first determined that they were more appropriately analogized to tying as opposed to predatory pricing violations.¹⁷⁶ The court explained that “[t]he principal anticompetitive effect of bundled rebates as offered by 3M is that when offered by a monopolist they may foreclose portions of the market to a potential competitor who does not manufacture an equally diverse group of products and who therefore cannot make a comparable offer.”¹⁷⁷ The Third Circuit found this case to be substantially similar to its earlier decision in *SmithKline*, and relied heavily on its analysis in that case.¹⁷⁸ Here, according to the court, 3M’s incentive was “to preserve the market position of Scotch-brand tape by discouraging widespread acceptance of the cheaper, but substantially similar, tape produced by LePage’s.”¹⁷⁹ The court found that the “bundled rebates reflected an exploitation of [3M’s] monopoly power”¹⁸⁰ such that, in some instances, the rebates 3M offered, which “required purchases bridging 3M’s extensive product line,” “were as much as half of LePage’s entire prior tape sales to that customer.”¹⁸¹ Thus, according to the court, a reasonable jury could have found that 3M “used its monopoly in transparent tape, backed by its considerable catalog of products, to squeeze out LePage’s.”¹⁸²

With respect to 3M’s exclusive dealing arrangements, even though the jury rejected LePage’s section 1 claim, the court determined that the jury reasonably could have found that 3M’s actual and de facto exclusive dealing contracts (ones that “effectively foreclosed the business of competitors”) amounted to exclusionary conduct in violation

171. *Id.* at 151.

172. *LePage’s Inc.*, 324 F.3d at 151-52.

173. *Id.* at 152.

174. *Id.*

175. *Id.* at 154.

176. *Id.*

177. *LePage’s Inc.*, 324 F.3d at 155.

178. *Id.*

179. *Id.* at 156.

180. *Id.*

181. *Id.*

182. *LePage’s Inc.*, 324 F.3d at 156.

of section 2.¹⁸³ According to the court, “foreclosure of markets through exclusive dealing contracts is of concern under the antitrust laws.”¹⁸⁴ The court further noted that “[d]iscounts conditioned on exclusivity are problematic ‘when the defendant is a dominant firm in a position to force manufacturers to make all-or-nothing choices.’”¹⁸⁵ Here, “the foreclosure caused by exclusive dealing practices was magnified by 3M’s discount practices, as some of 3M’s discounts were ‘all-or-nothing’ discounts, leading customers to maximize their discounts by dealing exclusively with the dominant market player, 3M, to avoid being severely penalized financially for failing to meet their quota in a single product line.”¹⁸⁶ The court determined that this was sufficient for a section 2 violation.¹⁸⁷

Based on the evidence, the court concluded a reasonable jury could have found that “the long-term effects of 3M’s conduct were anticompetitive.”¹⁸⁸ For example, there was sufficient evidence to conclude that 3M’s exclusionary conduct “cut LePage’s off from key retail pipelines necessary to permit it to compete profitably,”¹⁸⁹ and “that 3M intended to force LePage’s from the market, and then cease or severely curtail its own private-label and second-tier tape lines.”¹⁹⁰ 3M then would be in a position to recoup the profits it had forsaken by selling more units of higher priced Scotch tape. The court further found 3M’s interest in raising prices to be “well-documented in the record,”¹⁹¹ and that 3M’s practice of paying rebates after the end of the year discouraged passing the rebate on to the ultimate consumer. Evidence also showed that 3M’s bundled rebate program caused distributors to reduce drastically or eliminate purchases from LePage’s, causing them to choose between dropping any non-Scotch product line or losing the maximum rebate. The court further found that LePage’s could not practically match the rebates being offered by 3M, that its “earnings as a percentage of sales plummeted to below zero, to negative 10% during 3M’s rebate program,”¹⁹² that “[h]ad 3M continued with its program it could have eventually forced LePage’s out of the market,”¹⁹³ and that there were high barriers to entry. This fact distinguishes *LePage’s* from *Ortho Diagnostic Systems* in which the Second Circuit noted that the monopolist priced over even the competitor’s costs.¹⁹⁴ This and other evidence led the court to agree with the district court’s conclusion that “the record amply reflects that 3M’s rebate programs did not benefit the ultimate consumer.”¹⁹⁵ Finally, the Third Circuit rejected 3M’s business justifications for its conduct, finding substantial evidence that “3M entered the private-label market only to ‘kill it.’”¹⁹⁶

183. *Id.* at 157.

184. *Id.* at 158.

185. *Id.* (quoting 11 HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1807b, at 117 n.7 (1998)).

186. *Id.* at 159.

187. *LePage’s Inc.*, 324 F.3d at 159.

188. *Id.* at 163.

189. *Id.* at 160.

190. *Id.* at 163.

191. *Id.*

192. *LePage’s Inc.*, 324 F.3d at 161.

193. *Id.* at 162.

194. *Ortho Diagnostic Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455, 459 (S.D.N.Y. 1996).

195. *LePage’s Inc.*, 324 F.3d at 163.

196. *Id.* at 164.

VIII. *R.J. REYNOLDS V. PHILIP MORRIS*

Other cases have raised similar issues. Among these other cases is *R.J. Reynolds Tobacco Co. v. Philip Morris Inc.*¹⁹⁷ In that case, competing tobacco manufacturers sought a preliminary injunction challenging the implementation of a cigarette marketing program by Philip Morris.¹⁹⁸ The program at issue tied Philip Morris' most favorable discounts to the retailer's agreement to limit the percentage of in-store display space devoted to competitors' products.¹⁹⁹ Relying primarily on the balance of equities in the case, the district court granted an injunction barring Philip Morris from implementing certain provisions of the program.²⁰⁰ The court found that the Philip Morris plan "pose[d] a serious threat to interbrand competition by severely limiting and regulating in-store displays and advertisements of competing manufacturers."²⁰¹ In granting the preliminary injunction, the court noted that defendant Philip Morris had in excess of 50% of the market²⁰² in a highly concentrated industry in which the four leading cigarette manufacturers accounted for approximately 97% of all domestic sales.²⁰³ 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 eighty years.²⁰⁴ The court also took note of the fact that given the current economic, political, and regulatory environment it is unlikely that any significant new entrants will emerge in the foreseeable future.²⁰⁵ 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 the limitations that legislation and the tobacco litigation settlement have placed on the tobacco industry.²⁰⁶ The court therefore ordered that Philip Morris end the promotional practices that would have limited its competitors' ability to advertise at the point of sale.²⁰⁷

By the time the plaintiffs' suit against Philip Morris' program had reached the summary judgment stage, the program had been modified in ways that removed some of the restrictions on competitors' advertising. This, combined with the experiences with the program as modified by the earlier injunction, led the court to grant summary judgment for the defendants.²⁰⁸ The court rejected the plaintiffs' attempts to show market power either directly, through Philip Morris' ability to secure favorable deals with retailers, or circumstantially, through Philip Morris' market shares. The court concluded that direct proof was lacking because the plaintiffs were able to secure equally favorable terms.²⁰⁹ The court also concluded that, as a matter of law, Philip Morris' 51.3% market share was

197. *R.J. Reynolds Tobacco Co. v. Philip Morris Inc.*, 60 F. Supp. 2d 502 (M.D.N.C. 1999).

198. *Id.* at 504.

199. *Id.* at 507.

200. *Id.* at 509-10.

201. *Id.* at 511.

202. *R.J. Reynolds Tobacco Co.*, 60 F. Supp. 2d at 505.

203. *Id.* at 504.

204. *Id.*

205. *Id.* at 504-05.

206. *Id.* at 513.

207. *R.J. Reynolds Tobacco Co.*, 60 F. Supp. 2d at 513.

208. *R.J. Reynolds Tobacco Co. v. Philip Morris Inc.*, 199 F. Supp. 2d 362, 396-97 (M.D.N.C. 2002).

209. *Id.* at 381.

inadequate to establish market power under either section 1 or section 2.²¹⁰ The court then concluded that plaintiffs were not foreclosed from a substantial share of the relevant market to justify exclusive dealing or monopolization liability, as those plaintiffs were successful in promoting their product through alternative channels.²¹¹

IX. PEPSICO V. COCA-COLA

In *PepsiCo, Inc. v. Coca-Cola Co.*,²¹² plaintiff PepsiCo sued Coca-Cola over Coca-Cola'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 like Taco Bell and others that 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 that allowed it to distribute fountain-dispensed soft drinks through food service distributors rather than through local bottlers. Thus, according to its complaint, PepsiCo emerged as a new and revitalized threat to Coca-Cola's market dominance. In response, Coca-Cola allegedly embarked on a strategy to use its market power to perpetuate its monopoly by threatening food service distributors with the loss of Coke if they would dare to carry Pepsi for their customers who wanted Pepsi. Coca-Cola, in fact, did cut off any distributor that decided to carry Pepsi in addition to Coke.

The court reversed course and granted summary judgment for Coca-Cola, rejecting PepsiCo's proffered relevant market definition of "fountain syrup delivered by independent food service distributors."²¹³ The court concluded that the proper relevant market was the sale of soft drink syrup, and it was not limited to sales through a particular distribution channel. The court stated that "the mere preference for one form of delivery . . . does not create separate markets for the same product."²¹⁴ In rejecting PepsiCo's proposed market definition, the court emphasized the fact that customers viewed distribution through other means as reasonable and acceptable, even though some preferred independent distributors. The court also found that PepsiCo could have won sufficient distribution through bottlers, instead of food service distributors, by offering price reductions or other marketing strategies.²¹⁵

Although Coca-Cola's business strategy was somewhat different than those observed in *Concord Boat* and *LePage's*, it was similar in that it forced distributors to essentially make an "all or nothing" choice between selling Coke or selling Pepsi. The effect of forcing this all or nothing choice on distributors, when Coca-Cola's existing

210. *Id.* at 394.

211. *Id.* at 396.

212. *Pepsico, Inc. v. Coca-Cola Co.*, No. 98 Civ. 3282, 1998 WL 547088 (S.D.N.Y. Aug. 27, 1998).

213. *PepsiCo, Inc. v. Coca-Cola Co.*, 114 F. Supp. 2d 243, 248 (S.D.N.Y. 2000).

214. *Id.* at 250.

215. *Id.* at 251.

dominance made it a virtual necessity for distributors to carry Coke, was to create enormous artificial entry barriers for PepsiCo in the fountain-dispensed beverage market.²¹⁶ For this reason, the district court denied, on appropriate grounds, Coca-Cola's Rule 12 motion. While the court appropriately rejected the argument that a distribution channel cannot, as a matter of law, constitute a relevant market, it foreshadowed its summary judgment ruling by noting the difficulty of proving such a market.²¹⁷ Although the result is at odds with *Dentsply* and *Microsoft III*, which find illegal exclusion in the foreclosure of efficient distribution channels, it is distinguishable because it addresses only whether such a channel can constitute a relevant market, rather than analyzing the competitive effect in a downstream market by foreclosure of a particular channel.

X. *DENTSPLY*

Another interesting recent example of the use of these emerging theories is the DOJ's case against Dentsply.²¹⁸ In *United States v. Dentsply International Inc.*, the Third Circuit created significant doubt as to whether any safe harbors exist. In that decision the Third Circuit reversed the district court decision that rejected the DOJ's claims that exclusivity provisions by false tooth manufacturers were illegal monopolization.²¹⁹

The court ruled that an exclusivity policy imposed by a manufacturer (with monopoly power) on its dealers violates section 2 of the Sherman Act, reversing the decision of the district court and remanding the decision with directions to grant the government's request for injunctive relief.²²⁰ The court's decision falls back in line with cases that successfully challenged exclusive distribution practices of manufacturers with high market shares. The decision also demonstrates that courts will not hesitate to review such business arrangements with intense scrutiny under the antitrust laws.

In January 1999, the DOJ filed a civil action against Dentsply, the nation's largest manufacturer of dental equipment and supplies, charging Dentsply with unlawful exclusive dealing under section 3 of the Clayton Act and section 1 of the Sherman Act, and the willful maintenance of a monopoly under section 2 of the Sherman Act.²²¹ The DOJ alleged that Dentsply's policy with its dealers, Dealer Criterion 6, prevented competitors from successfully competing in the marketplace and hence was unlawful. Dentsply argued that its rivals "obtained a share of the relevant market, that there [were] no artificially high prices, and that competitors [had] access to all laboratories" through existing channels.²²² It also asserted that its success was due to "leadership in promotion and marketing," and not its dealer policy.²²³

Dentsply manufactures artificial teeth for use in dentures and other restorative

216. *PepsiCo, Inc.*, No. 98 Civ. 3282, 1998 WL 547088, at *18 (citing 3 PHILLIP AREEDA ET AL., ANTITRUST LAW ¶ 768e6 (2d ed. 2002)).

217. *Id.* at *11.

218. *United States v. Dentsply Int'l, Inc.*, 277 F. Supp. 2d 387 (D. Del. 1999); see also Complaint, *United States v. Dentsply Int'l, Inc.*, 277 F. Supp. 2d 387 (D. Del. 1999) (No. 99-005), available at <http://www.usdoj.gov/atr/cases/f2100/2164.htm>.

219. *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181 (3d Cir. 2005).

220. *Id.*

221. *Dentsply*, 277 F. Supp. 2d at 390.

222. *Dentsply*, 399 F.3d at 186.

223. *Id.*

appliances and sells them to dental products dealers. The dealers then “supply the teeth and other materials to dental laboratories, which fabricate dentures for sale to dentists. The relevant market is the sale of prefabricated artificial teeth for use in dentures in the U.S.”²²⁴ Dentsply dominates the artificial teeth industry “consisting of 12-13 competitors and a 75%-80% market share on a revenue basis, 67% on a unit basis, and is about 15 times larger than its next closest competitor.”²²⁵

Dentsply’s policy provides that in order to effectively promote Dentsply products, authorized dealers “may not add further tooth lines to their product offering.”²²⁶ As a result, dealers, although dissatisfied with the policy, did not give up the Dentsply teeth to take on a competitive line, and Dentsply’s chief competitors did not actively promote their products despite aggressive sales campaigns by Dentsply.²²⁷

The district court held that, although Dentsply’s business justification for its policy was “pretextual and designed to exclude its rivals from access to dealers . . . other dealers were available and direct sales to laboratories was a viable method of doing business.”²²⁸ The court concluded that Dentsply did not create “a market with supra competitive pricing, dealers were free to leave the network at any time,” and the DOJ failed to prove that Dentsply’s actions deterred entry.²²⁹ The district court denied the injunctive relief sought by the DOJ and entered judgment for Dentsply. The district court found that Dentsply had market power due to its predominant market share, however it concluded that Dentsply’s tactics did not have the power to exclude competitors from marketing products directly to dental laboratories.²³⁰ Moreover, the court found that the failure of Dentsply’s two rivals resulted from their own business decisions.²³¹

Despite Dentsply’s argument for a narrow market of only sales to dealers, the Third Circuit concluded that the relevant market was the total sales of artificial teeth in the United States both to laboratories and to dental dealers.²³² The Court explained that “laboratories are the ultimate consumers because they buy the teeth at the point in the process where they are incorporated into another product,” and that Dentsply concentrated its efforts at the laboratories as well as at dental schools and dentists.²³³

The Third Circuit disagreed with the district court’s findings, concluding that Dentsply’s exclusionary policy, not the apathy of rivals, foreclosed the market from competitors and allowed Dentsply to maintain monopoly power. The court stated that, “[t]he reality in this case is that the firm that ties up the key dealers rules the market,” and the district court “overlooked the point that the relevant market was the ‘sale’ of artificial teeth to both dealers and laboratories.”²³⁴ The court referred to *LePage’s Inc. v. 3M*²³⁵

224. *Id.* at 184.

225. *Id.*

226. *Id.* at 185.

227. *Dentsply*, 399 F.3d at 185.

228. *Id.* at 185-86.

229. *Id.* at 186.

230. *Id.* at 184.

231. *Id.*

232. *Dentsply*, 399 F.3d at 188.

233. *Id.*

234. *Id.* at 190.

235. *LePage’s Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003).

and *U.S. v. Microsoft*²³⁶ as similar cases where a manufacturer, through the use of exclusionary dealing, foreclosed competitors from a substantial percentage of the market.²³⁷

The Third Circuit found that the district court erred in concluding that Dentsply lacked market power.²³⁸ The court described Dentsply as “a manufacturer that sets prices with little concern for its competitors, ‘something a firm without a monopoly would have been unable to do.’”²³⁹ The court looked to evidence of Dentsply’s growth in profit margin, and the fact that Dentsply did not reduce its prices when competitors did not follow its increases.²⁴⁰

The Third Circuit found that, “by ensuring that the key dealers offer Dentsply teeth either as the only or dominant choice,” Dentsply’s policy has a “significant effect in preserving Dentsply’s monopoly,” helping “keep sales of competing teeth below the critical level necessary for any rival to pose a real threat to Dentsply’s market share.”²⁴¹ Interestingly, the court described Dentsply’s policy as “a solid pillar of harm to competition.”²⁴² The court also analyzed various ways in which dealers provide benefits in the artificial teeth market. Although the district court observed that laboratories prefer direct purchasing as a viable and cost-saving method, the Third Circuit emphasized that, “[f]or a great number of dental laboratories, the dealer is the preferred source for artificial teeth,” and that selling direct was not “practical or feasible in the market as it exists and functions.”²⁴³

The court also reviewed the efficacy of Dentsply’s policy and found that although the dealer relationships can be terminated, the dealers had a strong economic incentive to continue carrying Dentsply’s teeth.²⁴⁴ Despite the district court’s theory that a new or existing manufacturer could “steal” a Dentsply dealer, evidence of the “paltry penetration in the market by competitors over the years” demonstrated that this conclusion was clearly erroneous.²⁴⁵ In fact, “Dentsply’s grip on its 23 authorized dealers effectively choked off the market for artificial teeth, leaving only a small sliver for competitors.”²⁴⁶

The court held that the record amply supports that Dentsply’s alleged business justification was pretextual and did not excuse its exclusionary practices.²⁴⁷ The Third Circuit’s decision was significant in that it, like the ruling denying Coca-Cola’s motion to dismiss, took into consideration the realities of the market in which the parties participated. Even though Dentsply’s rivals could theoretically distribute teeth through alternative channels, the court noted that it was not a realistic alternative and therefore Dentsply illegally foreclosed its rivals by forcing an all or nothing choice on dealers.

236. *Microsoft III*, 253 F.3d 34 (D.C. Cir. 2001).

237. *Dentsply*, 399 F.3d at 187.

238. *Id.* at 190-91.

239. *Id.* at 191.

240. *Id.*

241. *Id.*

242. *Dentsply*, 399 F.3d at 191.

243. *Id.* at 192-93.

244. *Id.* at 194.

245. *Id.*

246. *Id.* at 196.

247. *Dentsply*, 399 F.3d at 197.

Thus, by finding foreclosure in the end market, the *Dentsply* court was able to find liability without limiting the relevant market to the distribution channel in question, as PepsiCo had attempted.

XI. AMERICAN AIRLINES

In the category of predatory pricing cases, the most interesting recent case is the government's civil action against American Airlines.²⁴⁸ The DOJ 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.²⁴⁹ 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.²⁵⁰

In *American Airlines II*, the DOJ claimed that American used predatory pricing to drive competing low cost carriers (LCCs) out of certain city-pair markets originating at Dallas-Fort Worth.²⁵¹ It alleged that, in response to entry from LCCs, American would either meet the price of the LCC, increase its capacity on routes served by the LCC, or increase the number of seats on those routes available at low prices.²⁵² American was successful at driving LCCs out of Dallas-Fort Worth, almost without exception, at which time American would gradually return to the pricing and capacity it had before the LCC entered.²⁵³ The government alleged that in addition to driving individual LCCs out of the market, American gained a reputation for predatory conduct that discouraged future LCC entry.²⁵⁴ The district court granted summary judgment for American, concluding that the government had proved neither below-cost pricing nor a dangerous probability of recovering lost profits that is necessary to prevail on a predatory pricing theory under *Matsushita*.²⁵⁵

The Tenth Circuit affirmed the district court. The court carefully analyzed and rejected each of the four measures of cost proffered by the government to measure the predatory effect of American's practices.²⁵⁶ The court concluded that two of the government's measures were invalid because they impermissibly considered fixed costs, which inflated the level of cost for predatory pricing purposes.²⁵⁷ The court then considered and rejected two measures of cost that resembled the Ordover and Willig profit maximization tests, described above.²⁵⁸ The first of these measures compared American's revenues from adding these routes with the profits on other routes that were

248. United States v. AMR Corp. (*American Airlines I*), 140 F. Supp. 2d 1141 (D. Kan. 2001).

249. See Janusz A. Ordover & Robert D. Willig, *An Economic Definition of Predation: Pricing and Product Innovation*, 91 YALE L.J. 8 (1981).

250. See *id.*

251. United States v. AMR Corp. (*American Airlines II*), 335 F.3d 1109 (10th Cir. 2003).

252. *Id.* at 1112.

253. *Id.*

254. *Id.*

255. *Id.*

256. *American Airlines II*, 335 F. 3d at 1116.

257. *Id.* at 1117.

258. *Id.* at 1118.

foregone. The second compared the revenue from incremental passengers with the average avoidable costs of adding that capacity.²⁵⁹ This measure approximated average variable cost by adding the incremental costs of new routes to a portion of total variable costs allocated to those new routes.²⁶⁰ The court rejected these measures as well, expressing doubt that profit sacrifice theories were tenable in light of *Brooke Group*.²⁶¹ The court rejected the first measure because in treating sacrificed profits as costs, the measure ran the risk of condemning conduct that was profitable.²⁶² The court also rejected the second profit sacrifice test because that test included “arbitrarily allocated variable costs.”²⁶³

XII. PER SE DEFENSES PROFFERED BY MONOPOLISTS

Monopolists in cases involving marketing strategies, particularly those where the facts are especially bad for monopolists, have argued there are certain per se defenses that 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.²⁶⁴ 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.²⁶⁵ 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 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.”²⁶⁶ Although the

259. *Id.*

260. *Id.* at 1118.

261. *American Airlines II*, 335 F.3d at 1118 (citing 3 PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 736(c)(2) (2d ed. 2002)).

262. *Id.*

263. *Id.* at 1120.

264. *See, e.g.*, *Concord Boat Corp. v. Brunswick Corp.*, 21 F. Supp. 2d 923, 929-30 (E.D. Ark. 1998); *see also Tom, supra* note 31.

265. *See, e.g.*, *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000); *LePage's Inc. v. 3M*, No. Civ. A. 97-3983, 2000 WL 280350 (E.D. Pa. Mar. 14, 2000); *see also SmithKline Corp. v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978); Ronald W. David, *Pricing With Strings Attached: At Sea in Concord Boat and LePage's*, 14 ANTITRUST 69 (2000).

266. *Concord Boat Corp.*, 207 F.3d at 1060 (quoting *Bathke v. Casey's Gen. Stores, Inc.*, 64 F.3d 340, 343

language of the opinion is murky, the court arguably established a presumption that in any section 2 case, conduct is presumably lawful so long as the price at which the monopolist sells its product is above its cost.²⁶⁷

The fallacy, indeed the perversity, of such a rule seems abundantly clear to knowledgeable antitrust scholars and practitioners. The Supreme Court has consistently observed that the *harm* from unlawful monopolization is that it enables the monopolist to charge an anticompetitively high, or supracompetitive, price.²⁶⁸ 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” that the Sherman Act is designed to prevent.²⁶⁹

However, in *Concord Boat*, the panel of the Eighth Circuit arguably has established that the only section 2 claim that can survive its scrutiny is a predatory pricing claim. Yet, as the Supreme Court has noted, “predatory pricing schemes are rarely tried, and even more rarely successful.”²⁷⁰ The Eighth Circuit confused the issue in *Concord Boat*. There, the issue—and challenged conduct—was not the price charged (as it is in predatory pricing cases). Rather, the issue—and the challenged conduct—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.²⁷¹ 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.²⁷² However, the success of this red herring defense in *Concord Boat* seems certain to lead to decisions in other cases that, hopefully, will lead to its explicit rejection by the Supreme Court.

Another per se defense proffered in some of these cases is the argument that so long as agreements that have the effect of restricting buyers’ purchases of rivals’ products are not “100% exclusive,” they cannot be unlawful exclusive dealing arrangements.²⁷³ This argument has also been appropriately rejected. As the district court in *Concord Boat* correctly observed, this argument is not only inconsistent with the mandate of *Kodak*²⁷⁴ 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 effects²⁷⁵ would be very similar. Even the misguided Eighth Circuit panel rejected the 100% exclusive defense.²⁷⁶

(8th Cir. 1995)).

267. *Id.* at 1061-62.

268. *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).

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

270. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986).

271. *Concord Boat Corp.*, 207 F.3d at 1039.

272. *See, e.g.*, David A. Balto, *Networks and Exclusivity: Antitrust Analysis to Promote Network Competition*, 7 GEO. MASON L. REV. 523, 569-70 (1999); *supra* note 31 and sources cited therein.

273. *See, e.g.*, *Concord Boat Corp. v. Brunswick Corp.*, 21 F. Supp. 2d 923, 932-33 (E.D. Ark. 1998).

274. *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992).

275. *See Concord Boat Corp.*, 21 F. Supp. 2d at 933.

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

Similarly, the courts in *Microsoft III* correctly observed that limiting rivals to a 25% share in a given distribution channel effectively foreclosed those rivals from the market.²⁷⁷

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*,²⁷⁸ *Carter Carburetor*,²⁷⁹ and *Brown Shoe*.²⁸⁰ The fact that anticompetitive effects are achieved through incentives for exclusivity rather than binding contractual commitments does not minimize, nor legalize, those effects. These arguments were appropriately rejected by the Third Circuit in *LePage's*,²⁸¹ and by the D.C. Circuit in *Microsoft III*.²⁸²

XIII. 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, nondominant 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.²⁸³

Another argument sometimes made by monopolists, and one that was vigorously argued by defendant Brunswick in *Concord Boat*, 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,

277. *Microsoft III*, 253 F.3d 34, 68, 70-71 (D.C. Cir. 2001).

278. *United Shoe Mach. Corp. v. United States*, 258 U.S. 451 (1922).

279. *Carter Carburetor Corp. v. Fed. Trade Comm'n*, 112 F.2d 722 (8th Cir. 1940).

280. *Fed. Trade Comm'n v. Brown Shoe Co.*, 384 U.S. 316 (1966).

281. *LePage's Inc. v. 3M*, 324 F.3d 141, 158 (3rd Cir. 2003)

282. *Microsoft III*, 253 F.3d at 71 (condemning Microsoft's provision of preferential support to software vendors, contingent on exclusivity for Internet Explorer).

283. *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 488 (1992) (Scalia, J., dissenting) (citing 3 PHILLIP AREEDA & DONALD F. TURNER, ANTITRUST LAW ¶ 813 (1978)). See also *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 275 (2d Cir. 1979); 3 PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 802(d) (2d ed. 2002) (discussing higher scrutiny for defendants with substantial market power in antitrust cases).

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.

The Eighth Circuit, in *Concord Boat*, 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.²⁸⁴

XIV. 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 *Kodak*, each antitrust case must be resolved upon its own unique facts.²⁸⁵ 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 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.²⁸⁶ 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 that 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

284. *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1059 (8th Cir. 2000). 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, could achieve minimum viable scale.

285. *Kodak*, 504 U.S. at 467.

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

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 analysis, 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 less restrictive alternatives exist that would produce the same efficiencies or pro-competitive effects.

Although the decision in *Concord Boat* is disheartening to advocates of thoughtful, fact-based analysis of alleged predatory conduct, one can remain hopeful. 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.