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Competition Is Good Again

Supreme Court has pulled back from micromanaging the battle for market share.

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Decades ago, antitrust law imposed severe limits on the sound discretion of business people, often quashing—rather than supporting—their entrepreneurial spirit. The courts, and thus antitrust counselors, put the brakes on economically rational, pro-competitive conduct to avoid perceived anti-competitive effects on rivals as well as consumers.

Terminate a distributor? Not unless you wanted to spend the next three years in court. Prevent distributors from price-gouging customers? Not unless you wanted the Justice Department breathing down your neck. Raise prices? Not unless you liked being accused of price fixing. Lower prices? Not unless you wanted to risk paying treble your competitors' claimed losses.

Antitrust
A Practice Focus

The amorphous language of the Sherman Act, vaguely condemning "restraints of trade" and "monopolization," allowed for such interpretations. The prevailing economic theory was really the analytical equivalent of "many competitors, good; few competitors, bad." Companies could compete, but not *too* hard.

In his seminal 1978 treatise, *The Antitrust Paradox,* Robert Bork lamented the ironically anti-competitive effect of antitrust laws. In his view, all conduct short of price fixing, horizontal conspiracies, and mergers of entire industries should be per se lawful; Section 1 of the Sherman Act should be gutted; Section 2 should be eliminated; vertical restraints should be praised; and 100 years of antitrust precedent should be thrown out the window.

These were radical arguments at the time, but not anymore. The so-called Chicago school of economics now permeates every area of antitrust law. Once-standard avenues of attack have been cut off. The government has largely packed its protectionist bags and limited its focus to horizontal price-fixing agreements and mergers to monopoly or duopoly. Not since 1992, when the Supreme Court adopted a narrow market definition in *Eastman Kodak Co. v. Image Technical Services Inc.,* has there been a significant pro-plaintiff antitrust decision.

How was this revolution accomplished? First, the Court addressed the constraints of stare decisis. In *State Oil Co. v. Khan* (1997), it declared that it would no longer be bound by its prior decisions when, in its view, "the theoretical underpinnings of those decisions are called into serious question."

Second, the Court had to legitimatize the bulk of then-illegal activities without disregarding the Sherman Act or subjecting itself to attack as judicially activist. The solution? Rather than declaring these activities lawful, the Court declared them not per se unlawful. Although plaintiffs could still mount a challenge, they would henceforth need to prove, under a "rule of reason" or Section 2 monopolization analysis, an actual adverse effect on competition, not just competitors.

The upshot of this antitrust revolution is that companies, large and small, are now free (in almost every area) to employ economically rational competitive strategies, regardless of the impact on weaker rivals.

UNFETTERED IN DISTRIBUTION

The most significant antitrust change has been the near-total control that manufacturers have been given over their distribution systems. Until recently, termination of a distributor—historically, the most litigious of antitrust plaintiffs—could give rise to a bevy of per se claims, including vertical price fixing, horizontal price fixing, and group boycotts. The Supreme Court has systematically shut the door on each.

In *Business Electronics Corp. v. Sharp Electronics Corp.* (1988), the Court rejected the argument that termination of a price-discounting distributor constituted a vertical price restraint. In *Monsanto Co. v. Spray-Rite Service Corp.* (1984), the Court had rejected the notion that such a termination could be deemed "horizontal" when competing dealers lobbied for it. And in *Nynex Corp. v. Discon Inc.* (1998), the Court held it was no longer a "group boycott" to refuse to deal with one distributor in favor of another, noting that the "freedom to switch suppliers lies close to the heart of the competitive process." Today, businesses are essentially free to structure their distribution systems as they see fit.

And this freedom extends beyond picking and choosing distributors. In 1977, the Court took its first major step toward legitimizing all vertically oriented business decisions when it eliminated the per se rule against vertical nonprice restraints. Recognizing that every company seeks efficient distribution of its products, the Court in *Continental T.V. Inc. v. GTE Sylvania Inc.* expressly approved of exclusive territories, customer allocations, and other restrictions on the competitive activities of those above or below the company on the distribution chain.

But *GTE* was just the beginning. The price/nonprice dichotomy it created stood on shaky ground and was bound to fail. In 1997, the Court in *Khan* allowed manufacturers to cap their distributors' resale prices, reasoning that there was nothing wrong with preventing dealers from gouging consumers.

This left all vertical restraints free from serious attack, save for one last vestige: the 1911 prohibition against minimum resale price maintenance. This term the Court agreed to revisit *Dr. Miles Medical Co. v. John D. Park & Sons Co.* in *Leegin Creative Leather Products Inc. v. PSKS Inc.* If, as is widely expected, the justices subject vertical price fixing to a rule-of-reason analysis, the last restraint on vertical control of a company's distribution system will disappear.

Unilateral in Pricing

If a company is free to control distribution, surely it should be free—unilaterally—to set its own prices. But through much of antitrust's history, a company could be attacked for charging too much, too little, or even the right amount to each customer. Not so today.

Pricing too low is now a good thing. Before *Brooke Group v. Brown & Williamson Tobacco Corp.* (1993), predatory-pricing claims were perhaps the most powerful weapon a competitor had to limit price competition. So unsettled was the law that even above-cost pricing could create antitrust risk. Rejecting this prod to raise prices, the Court in *Brooke Group* lamented that its 1967 decision in *Utah Pie Co. v. Continental Baking Co.* had been interpreted to permit liability for low but above-cost pricing often "on a mere showing that the defendant intended to harm competition or produced a declining price structure."

To eliminate this, the Court imposed two requirements—"below-cost pricing" and "monopoly recoupment"—as a threshold for any claim that a rival prices products "in an unfair manner." This test has proved virtually impossible to meet.

The logic in the *Brooke Group* decision has now been extended beyond predatory pricing. Recognizing that there is no analytical difference between driving a rival from the market by pricing a finished good below cost and paying a higher price to corner the market for a critical input, the Court last month held in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.* that *Brooke Group* applies to "predatory bidding" as well. The Court held that the same standard should apply because both claims "logically require firms to incur short-term losses on the chance that they might reap supracompetitive profits in the future."

Despite the narrowness of its fact pattern, *Weyerhaeuser* has implications that are quite broad. Many claims involve short-term losses that are incurred, arguably, to reap supracompetitive profits down the road. The Court's stated skepticism of such claims is a resounding rebuke to decisions like *LePage's Inc. v. 3M,* in which the U.S. Court of Appeals for the 3rd Circuit condemned (over then-Judge Samuel Alito Jr.'s dissent) an alleged monopolist's bundled rebate program.

This spells the logical end of antitrust liability for offering economically rational low prices for exclusivity. As such, bundled rebates, market-share discounts, and the like should now be beyond reproach, so long as the incentive payments do not exceed the profits on the incremental volume they generate.

Pricing too high is not necessarily a bad thing. Given that setting prices at what the market will bear is the nature of competition, the Court has also taken steps to reduce the risk of "high" prices. Concluding that it has been too easy to allege conspiratorial price increases, the Court has recently begun to restrict efforts to shoehorn unilateral conduct into a horizontal price-fixing framework.

Last year, the Court in *Texaco Inc. v. Dagher* rejected claims that Shell and Texaco conspired through the auspices of a joint venture to end their competition. The lower courts had applied the per se rule because an agreement to fix prices was supposedly not necessary to achieve the joint venture's claimed efficiencies. The Supreme Court reversed, concluding that the rule of reason governs both the formation of the venture and the joint setting of prices through it.

Similarly, the Court has also sharply limited the inferential effect of ambiguous evidence in establishing horizontal price fixing, which is still per se illegal. It is no longer sufficient for a plaintiff to point to parallel conduct and a few meetings among competitors.

In *Brooke Group,* the Court held that typical follow-the-leader behavior—called "conscious parallelism"—was perfectly legitimate. In 1986, the Court in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.* had directed lower courts to award summary judgment unless the evidence "tends to exclude the possibility" of legitimate conduct. Because the inference that every meeting among rivals harbors an illicit purpose is no longer tenable, it is now more difficult to prevail in a civil price-fixing case without the type of confessional evidence that the Justice Department obtains through its amnesty program and the threat of jail for noncooperating executives.

That burden will likely become even tougher. *Bell Atlantic Co. v. Twombly*, a Supreme Court case now under review, is widely expected to produce a precedent increasing plaintiffs' pleading burden, either by extending *Matsushita* to motions to dismiss or by requiring specific factual allegations objectively constituting a good-faith basis for accusing a company of price fixing.

Price discrimination is largely irrelevant. Another favorite of disgruntled distributors has been the Robinson-Patman Act's prohibition against price discrimination. The antitrust cognoscenti have long maintained that the act was, in Bork's words, "the misshapen progeny of intolerable draftsmanship coupled to wholly mistaken economic theory."

But the judiciary could not disregard the law simply because it was enacted by a Congress that distrusted large corporations and mistakenly believed that protection of numerous small companies would promote competition. It was not until last year that the Supreme Court found a way to gut the act.

In *Volvo Trucks North America Inc. v. Reeder-Simco GMC Inc.,* the Court rejected an inference of "competitive injury" where there was evidence of sustained price discrimination—an inference grounded in almost 60 years of precedent—because the seller had individually negotiated specifically tailored programs with customers or end users. To rule otherwise, the Court held, would be to permit liability based on evidence of "a mix-and-match, manipulative quality."

The Court also laid the groundwork for further limiting Robinson-Patman by "declin[ing] to extend" it to cases where the favored purchaser lacks market power and so bears "little resemblance to the large independent department stores or chain operations" that sparked the act's passage. The Court declared that it would strive mightily to "resist [any] interpretation geared more to the protection of existing competitors than to the stimulation of competition."

Volvo has widely been declared the death knell of Robinson-Patman.

Tying Not Off-Limits

If companies have unfettered discretion to unilaterally set prices, they should have similar discretion to unilaterally set other terms of sale. But the law against tying has long posed a bar.

In 2006, however, the Court in *Illinois Tool Works Inc. v. Independent Ink Inc.* re-evaluated its per se prohibition against tying. At issue was the well-known razor/razor blade business model, i.e., selling the razor cheap but gouging the customer on the replacement blades. A similar model applies (with varying success) to all manner of products, including—as in *Illinois Tool Works*—printers and ink cartridges.

For the model to work, the seller of the razor/printer/product system must be able to prevent customers from buying the cheaper, generic components from another company. Sometimes this can be achieved only by forcing those who wish to buy, say, the seller's printer to buy the seller's ink cartridges too.

Because such arrangements clearly eliminate competition in the tied product, the Court had applied a per se rule of illegality since the early 1900s. Nonetheless, the Court over the years came to see that tying arrangements can be pro-competitive.

The Court in *Jefferson Parish Hospital District No. 2 v. Hyde* (1984) took a major step by limiting application of the per se rule to cases where the defendant used its "market power" in one product to "force" customers to purchase an entirely "separate" product. This essentially legitimized "package deals," which have since become standard in American commerce.

Until last year, however, it was still presumed unlawful for a patent holder to tie a related product to its patented product. *Illinois Tool Works* changed this. Now tying is only unlawful when it is "the product of a true monopoly or marketwide conspiracy."

Monopolization Harder to Prove

The Supreme Court's efforts to limit antitrust's reach have not been limited to Section 1. As noted, rather than declare a range of commercial practices per se lawful, the Court shifted the analytical focus to Section 2 monopolization or its equivalent, the rule of reason. But even this would not have legitimized much of the conduct that per se rules had previously invalidated unless the Court simultaneously raised the bar for those claims.

The Court in *California Dental Association v. Federal Trade Commission* (1999) explained that lower courts should not just apply a "quick look" rule-of-reason analysis but must engage in a full-scale balancing test of anti-competitive harms versus pro-competitive benefits. Similarly, the Court in *Spectrum Sports Inc. v. McQuillan* (1993) barred claims where the conduct merely gives a monopolist an unfair "competitive advantage" in a separate market, short of monopoly. *Brooke Group* and *Weyerhaeuser* further expressed skepticism about claims alleging "the deliberate use of unilateral pricing measures for anti-competitive purposes."

But most significantly, the Court in *Verizon Communications Inc. v. Trinko* (2004) rejected the notion that a monopolist's "bad" conduct violates Section 2 just because it perpetuates a monopoly. As elsewhere in this recent string of cases, *Trinko*'s fact pattern was esoteric; however, the principles it enunciated were broad and of general applicability.

The plaintiff in *Trinko* claimed that Verizon, an alleged monopolist, failed to give a competitor statutorily required access to its network. In rejecting the claim, the Court held that a Telecommunications Act violation does not a Sherman Act violation make, even though the defendant's conduct was expressly designed to perpetuate its monopoly.

The Court then rejected the plaintiff's alternative argument that, under *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.* (1985), Verizon's conduct should be deemed predatory and exclusionary if it harms rivals and cannot be justified on the basis of efficiency. Instead, the Court limited *Aspen Ski* to its facts as a decision that sits "at or near the outer boundary" of Section 2 liability.

Taken all together, the Court's jurisprudence over the past 15 years demonstrates the near impossibility (notwithstanding some lower-court opinions to the contrary) of making out a successful antitrust claim unless the defendant engages in some form of conduct that (1) aggregates horizontal market power (through merger or agreement, as in price fixing and standard setting) or (2) is economically irrational but for its tendency to destroy rivals and thereby raise prices above competitive levels (as in *Brooke Group*).

And this is a good thing. Consumers benefit when companies engage in a bare-knuckle brawl to increase market share. The Supreme Court, cognizant of its own limitations in micromanaging the terms of battle, has done what it can to limit spurious claims. Now the antitrust laws should no longer be feared by companies that behave rationally and unilaterally.

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