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Section 2 Symposium: Bill Kolasky on a Stepwise Rule of Reason for Exclusionary Conduct
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The most controversial part of the Justice Department's Single Firm Conduct Report is the Department's proposed use of what it terms a "substantial disproportionality" test for exclusionary conduct. Under this test, the Justice Department would bring a case only if the harm to consumers and competition caused by a dominant or near-dominant firm's conduct is "substantially disproportionate" to any legitimate benefits the firm might realize. The Department argues that this test is superior to the three alternative tests it considers—an effects-balancing test, a no-economic-sense test, and an equally-efficient-competitor test—because it is more administrable and because it reduces the risk of false positives (i.e., finding conduct unlawful that does not harm competition), which the Department views as more serious than that of false negatives (i.e., finding conduct lawful that does harm competition).

Critics of the Department's report argue that this test places a finger on the scale in favor of monopolists and near-monopolists, leaving consumers and smaller competitors with too little protection, and it is certainly easy to see why the test gives rise to this perception. But there is another, more fundamental problem with the Justice Department's proposed test – namely, that it perpetuates the outdated view of the rule of reason as an ad hoc balancing test, and does not take into account the extent to which the Supreme Court and the lower courts have given greater structure to rule of reason analysis over the last thirty years.Part of the problem is that courts do not generally describe the analytical framework they use to apply Section 2 as a "rule of reason" framework in the same manner as they do under section 1. Yet, as the D.C. Circuit recognized in its *Microsoft* decision, Section 2 analysis proceeds very much in the same stepwise manner as modern rule of reason analysis under section 1. Thus, the plaintiff has the initial burden of showing that the conduct at issue is "anticompetitive" in the sense that it tends "to exclude rivals on some basis other than efficiency" (*Aspen*) – in other words, that excludes or handicaps rivals without benefiting consumers. If the plaintiff meets this initial burden, then the defendant may try to rebut the plaintiff' showing by proffering a procompetitive justification for its conduct. If it does so, then the burden shifts back to the plaintiff to rebut that claim by, for example, showing that the claimed justification is pretextual or that it could be achieved through less competitively restrictive alternatives. If the plaintiff cannot rebut the procompetitive justifications in this

manner, then the plaintiff must demonstrate that the anticompetitive harm outweighs the procompetitive benefits.

These, of course, are the same steps courts follow in analyzing alleged restraints of trade under modern section 1 rule-of-reason analysis. What the Justice Department report overlooks in proposing its substantial disproportionality test is that the courts almost never reach the last step of this analysis, in which they overtly balance the anticompetitive and procompetitive effects of the alleged conduct. Rather, as Professor Michael Carrier of Rutgers has documented, courts resolve virtually all rule-of-reason cases, under both section 1 and section 2, at one of the first three steps. They do this by applying what the Supreme Court in *California Dental Association v. FTC*, called a "sliding scale" or, more elegantly, an "enquiry meet for the case." Thus, they rarely, if ever, actually balance the anticompetitive and procompetitive effects.

At the first step, the courts generally require a plaintiff to show substantial harm to competition in order to meet its initial burden. Harm to a single competitor, or trivial harm to competition, will not do. Then at the second step, the degree of scrutiny to which a court subjects any proffered justifications will depend on how strong the showing of harm to competition is. In cases like *NCAA* and *Indiana Federation*, where the harm to competition is obvious and substantial, the court will scrutinize the proffered justifications closely and will look hard for less restrictive alternatives. Conversely, where the showing of harm to competition is weak, the degree of scrutiny of proffered justifications will be much more casual.

The stepwise, sliding-scale framework the courts now use to apply the rule of reason is very similar to the more structured framework the Supreme Court has developed over the last forty years to enforce the constitutional guarantees of free speech and equal protection. In the 1960s, there was a debate over whether the courts should use a balancing test to protect these rights or should instead try to develop neutral principles to enforce them. The Court resolved this debate by converting what had been an ad hoc balancing test into a more structured stepwise inquiry that looks first at the nature of the infringement and then varies the degree of scrutiny to which the court will subject the proffered governmental justifications with the seriousness of the infringement.

Because the Justice Department report fails to acknowledge that the rule of reason has likewise evolved from an ad hoc balancing test to a structured, stepwise, sliding-test test for anticompetitive conduct, its concern that the rule of reason, if applied neutrally, will produce too many false positive seems exaggerated. When one examines Section 2 decisions in the Supreme Court and the courts of appeals over the last quarter century, it is hard to find evidence to support the Department's fear that false positives are more likely and more serious than false negatives. Plaintiffs have won very few Section 2 cases, and most of those wins are in cases like *Conwood* and *Microsoft*, where the evidence of harm to competition was quite strong and the proffered justifications very weak.

The bottom line is that the Department, by neglecting to review the case law under section

2, failed to make a persuasive case for its substantial disproportionality test. It would have been far better for it to have more fully embraced the rule of reason analytical framework enunciated by the D.C. Circuit in *Microsoft*, but with more emphasis on the need to use a sliding scale in applying that framework, which the Supreme Court endorsed in *California Dental*.

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