SECTION 2, SAFE HARBORS, AND THE RULE OF REASON

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INTRODUCTION: THE MYSTERIES OF COPPERWELD

This symposium's topic is the antitrust treatment of single-firm conduct. Single-firm (or "unilateral") conduct is a relevant organizing principle because, as the Supreme Court observed in Copperweld Corp. v. Independence Tube Corp.,¹ "[t]he Sherman Act contains a basic distinction between concerted and independent action."² This "basic distinction" manifests itself in the Sherman Act’s text, under which "[t]he conduct of a single firm is governed by § 2 alone and is unlawful only when it threatens actual monopolization."³ Thus, "[i]t is not enough that a single firm appears to 'restrain trade' unreasonably" because "Congress authorized Sherman Act scrutiny of single firms only when they pose a danger of monopolization."⁴ Put differently, unilateral conduct posing no threat of monopolization effectively enjoys an antitrust "safe harbor."⁵

Sound policy reasons, it is said, underpin Copperweld’s antitrust free-fire zone for non-monopolizing single-firm conduct. For one thing, unilateral conduct is ubiquitous; a firm cannot operate without engaging in some acts or omissions.⁶ If unilateral conduct is the commercial equivalent of breathing, then judicial scrutiny of all unilateral conduct for reasonableness threatens suffocation. Because "it is sometimes difficult to distinguish ro-

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² Id. at 767 (quoting Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984) (internal quotation marks omitted)).

³ Id.

⁴ Id. at 767-68.


bust competition from conduct with long-run anticompetitive effects," the Copperweld court explained, subjecting a firm’s every act or omission to antitrust scrutiny absent a threatened monopoly screen could “dampen the competitive zeal of a single aggressive entrepreneur.” By contrast, concerted action, governed principally by Sherman Act Section 1, requires collaboration. Concerted action, the argument and analogy thus runs, goes beyond breathing and is in some sense exceptional.

For another, concerted action, Copperweld asserted, “is fraught with anticompetitive risk.” “Certain agreements, such as horizontal price fixing and market allocation, are thought so inherently anticompetitive that each is illegal per se without inquiry into the harm it has actually caused.” And even if the Rule of Reason rather than a per se rule applies, the “anticompetitive potential” of concerted action “is sufficient to warrant scrutiny even in the absence of incipient monopoly.” By contrast, it is argued, “unilateral exclusionary conduct of the sort that Section 2 uniquely addresses probably poses little threat to consumer welfare.”

So is the received wisdom. But are single-firm and concerted conduct really so different? Pressing on each pillar of the unilateral/concerted dichotomy (difference in nature of conduct; difference in anticipated consequences) suggests that each is more wobbly than Copperweld advanced. For example:

(1) Distinguishing “unilateral” from “concerted” conduct is not always straightforward, either conceptually or as a matter of evidentiary sufficiency. Take vertical agreements. Colgate and Monsanto bequeathed a complicated doctrine for inferring agreements. An agreement cannot be established merely from a manufacturer’s acquiescence to retailer-demanded conduct, even though in a lay sense one might deem request fol-

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8 Copperweld, 467 U.S. at 768 (“Section 1 of the Sherman Act . . . reaches unreasonable restraints of trade effected by a ‘contract, combination . . . or conspiracy’ between separate entities.”).
9 Id. at 768-69. See generally Meese, supra note 7, at 32-35 (discussing justification for Copperweld’s distinction between unilateral and concerted action).
10 Copperweld, 467 U.S. at 768 (citing N. Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958)).
11 Id. at 769.
12 Charles F. (Rick) Rule, The Section 2 “Mess”: Do We Really Need It or Can We at Least Make It Better?, Written Submission to the Antitrust Modernization Commission 12 (Sept. 29, 2005) (on file with author). See also id. at 5-6 (arguing that “exclusionary conduct” harms consumer welfare only indirectly”). Indeed, Rule argues, consumers would be better off if the antitrust laws did not reach unilateral conduct and Section 2 were repealed. Id. at 12.
15 See generally ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 3-26 (6th ed. 2007).
owed by acquiescence an agreement to engage in the sought conduct.\(^\text{16}\) This difficulty in defining and ascertaining concerted action pervades the entire field of vertical agreements, extending not only to vertical price-fixing (now less relevant after the Supreme Court overruled \textit{Dr. Miles}\(^\text{17}\)), but also to tying, exclusive dealing, and other vertical practices;

(2) Similar issues cloud identifying horizontal agreements. The Sherman Act’s “basic distinction” between unilateral and concerted action precludes applying Section 1 to mere oligopolistic coordination.\(^\text{18}\) But many have questioned why this is so, since such interdependent conduct, too, can be viewed as “offer” followed by “acceptance.”\(^\text{19}\) Indeed, courts inferring “agreements” from price-signaling have been duly criticized as effectively condemning mere interdependence.\(^\text{20}\) And whether parallel behavior exhibits “plus” factors that can support an inference of agreement often is sharply disputed.\(^\text{21}\) The upshot is this: whether clear, undisputed facts add up to a Sherman Act agreement is often not self-evident. The conduct must be characterized;

(3) Even when conduct is indisputably “unilateral” or “concerted,” characterization is often required to determine which conduct is subject to antitrust scrutiny. Consider the quotidian act of selling at a particular price. If a rival challenges the conduct as illegal, what act is subject to challenge? Only the “unilateral” act of \textit{setting} the price, subject only to Sherman Act Section 2? Or also the “concerted” act of \textit{selling} at that price, in principle subject to Sherman Act Section 1 because it involves a sales transaction (concerted action)?\(^\text{22}\) If the answer is that \textit{setting} the low price is the offense and that Section 1 is not implicated (that is, the sale transaction, which just

\(^{16}\) See, e.g., Bailey’s Inc. v. Windsor Am., Inc., 948 F.2d 1018, 1027-29 (6th Cir. 1991) (requiring “evidence that reasonably tends to prove . . . a conscious commitment to a common scheme designed to achieve an unlawful objective” (quoting Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 764 (1984))).


\(^{19}\) E.g., \textit{In re} High Fructose Corn Syrup Antitrust Litig., 295 F.3d 651, 654 (7th Cir. 2002) (Posner, J.) (“If a firm raises price in the expectation that its competitors will do likewise, and they do, the firm’s behavior can be conceptualized as the offer of a unilateral contract that the offerees accept by raising their prices.”).


\(^{21}\) See, e.g., Toys “R” Us, Inc. v. FTC, 221 F.3d 928, 934-95 (7th Cir. 2000).

\(^{22}\) See, e.g., Multistate Legal Studies, Inc. v. Harcourt Brace Jovanovich Legal & Prof’l Publ’ns, Inc., 63 F.3d 1540, 1548-49 (10th Cir. 1995) (recognizing Section 1 predatory pricing theory); W. Concrete Structures Co. v. Mitsu & Co., 760 F.2d 1013, 1015-18 (9th Cir. 1985) (pre-Brooke Group case permitting a Section 1 predatory pricing claim). This issue matters because employing Section 1 to attack predatory pricing arguably could circumvent aspects of \textit{Brooke Group’s} recoupment requirement.
implements the price, must be ignored), should payments for exclusive dealing be treated any differently (that is, the agreement ignored and only the consideration for it subject to challenge)?\(^2\) So-called “product design” cases raise similar issues.\(^2\) Technological integration, rather than contractual restrictions, may arguably cause separate products to be unavailable except in a package. Is only the technological integration by the monopolist (a unilateral act) subject to challenge, or is there also an explicit “agreement” by the customer (concerted action subject to Section I) only to take one product if it takes the other?\(^2\) Once again, whether the relevant conduct is concerted or unilateral requires not merely analysis, but also characterization and judicial choice; and

(4) The Copperweld court’s sweeping assertion that “[c]oncerted activity inherently is fraught with anticompetitive risk”\(^2\) has come under significant attack. Certain unilateral conduct, it is argued, may significantly threaten consumer welfare, particularly in the presence of network effects or other factors that may create durable entry barriers.\(^2\) By contrast, it is also argued, many mergers, joint ventures, and other forms of concerted conduct pose little, if any, anticompetitive threat, even if one or more of the participants has market power.\(^2\) The notion that concerted (even if horizontal) conduct is somehow exceptional increasingly lacks force when vast portions of the economy require competitor collaboration.\(^2\)

\(^2\) Cf. NicSand, Inc. v. 3M Co., 507 F.3d 442, 452 (6th Cir. 2007) (en banc) (analyzing up-front discounts offered for exclusivity under predatory-pricing principles). The intersection of refusals to deal and vertical agreements (such as exclusive dealing and tying) raises similar issues. Cf. United States v. Dentsply Int’l, Inc., 399 F.3d 181, 186, 193 (3d Cir. 2005) (reasoning that exclusionary term enforced through a threat of future refusal to deal is “realistically . . . as effective as those in written contracts”).

\(^2\) See infra Part III.A.

\(^2\) Cf. United States v. Microsoft Corp., 253 F.3d 34, 84-85 (D.C. Cir. 2001) (en banc) (per curiam) (Microsoft conduct subject to Section 1 tying analysis included mix of contractual restriction and design decisions).


\(^2\) See, e.g., Polk Bros., Inc. v. Forest City Enters., Inc., 776 F.2d 185, 188-89 (7th Cir. 1985) (Easterbrook, J.) (“Cooperation in the basis of productivity. It is necessary for people to cooperate in some respects before they may compete in others, and cooperation facilitates efficient production. . . . Joint ventures, mergers, systems of distribution—all these and more require extensive cooperation, and all are assessed under a Rule of Reason that focuses on market power and the ability of the cooperators to raise price by restricting output. The war of all against all is not a good model for any economy. Antitrust law is designed to ensure an appropriate blend of cooperation and competition, not to require all economic actors to compete full tilt at every moment.” (citations omitted)); Thomas M. Jorde & David J. Teece, *Rule of Reason Analysis of Horizontal Arrangements: Agreements Designed to Advance Innovation and Commercialize Technology*, 61 ANTITRUST L.J. 579, 600-09 (1993) (arguing for applying an “innovation-sensitive” Rule of Reason to horizontal agreements that raises the threshold for demonstrating substantial market power).

\(^2\) Some argue that collusive and exclusionary conduct can be distinguished based on which actors experience the conduct’s consequences. For example, it is argued that a collusion case focuses on
Renewed interest by courts, agencies, and commentators in determining the content of Section 2 of the Sherman Act has placed yet new stress on the unilateral/concerted dichotomy—and, some would argue, has further eroded *Copperweld*’s “basic distinction.” Starting with *United States v. Microsoft Corp.*,[30] the last decade has witnessed a renaissance of Sherman Act Section 2 litigation, a development which has focused antitrust academics, courts, the agencies, and others on Section 2 legal tests.[31] Some argue that Section 2 requires applying a specific legal test (for example, the profit-sacrifice test or the Rule of Reason’s “balancing” test) to most or all conduct covered by that statute.[32] By contrast, others (including this author) contend that Section 2 is not one size fits all.[33] Rather, different legal tests properly govern the diverse conduct subject to Section 2; the appropriate test, depending on the circumstances, might include balancing, the “no eco-

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nomic sense” or profit-sacrifice test, or a combination of different screens, rules, and standards as appropriate.  

Courts have not yet definitely resolved the debate between the “single test” and “multiple tests” Section 2 camps. However, Section 2 courts increasingly identify the Rule of Reason as an appropriate Section 2 legal test. Indeed, some courts have seemingly held, Section 2 requires applying the Rule of Reason. These decisions implicitly refute those who read Copperweld’s statement that “[c]oordinated activity subject to § 1 is judged more sternly than unilateral activity under § 2” to require applying a stricter test than Rule of Reason balancing to unilateral conduct. Instead, these decisions imply, Copperweld more modestly means that Section 2 is not implicated—that is, unilateral conduct cannot be subject to the Rule of Reason—unless the conduct threatens monopolization. In other words, precluding the Rule of Reason’s applicability to non-monopolizing unilateral conduct is the fundamental sense in which “Congress treated concerted behavior more strictly than unilateral behavior.”

This seeming triumph of the Rule of Reason as supplying content to Section 2, however, leaves a significant question: how can the Rule of Reason, in its usual sense of “balancing” competitive effects (or, put differently, determining conduct’s net effects on long-run consumer welfare), coexist with courts’ refusal to apply “balancing” tests to certain conduct—most notably claims challenging pricing too low and refusals to deal? In other words, if Section 2, as the Supreme Court held in the seminal Standard Oil case, implements the same Rule of Reason as Section 1, how can

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34 See id.
38 Copperweld, 467 U.S. at 768; cf. Cascade Health Solutions v. PeaceHealth, 502 F.3d 895, 921-22 n.22 (9th Cir. 2007) (“The ‘predatory or anticompetitive conduct’ element of § 2 attempt, like the conduct element of monopolization, encompasses more than violations of § 1.” (quoting Cal. Computer Prods., Inc. v. IBM Corp., 613 F.2d 727, 737 (9th Cir. 1979) (internal quotation marks omitted))), amended by 515 F.3d 883 (9th Cir. 2008).
40 See Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 415-16 (2004) (“[The Sherman Act does not give judges carte blanche to insist that a monopolist alter its ways of doing business whenever some other approach might yield greater competition.”).
41 Standard Oil Co. of N.J. v. United States, 221 U.S. 1, 61-62 (1911) (“When the 2d section of the Sherman Act is thus harmonized with . . . the 1st, it becomes obvious that the criteria to be resorted to in any given case for the purpose of ascertaining whether violation of the section have been committed is the rule of reason guided by established law.”).
that same Rule of Reason not apply to certain Section 2 conduct, as the Supreme Court also has held.\footnote{See Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069, 1076-78 (2007) (predatory bidding); \textit{Trinko}, 550 U.S. at 415-16 (refusal to deal); \textit{Brooke Group}, 509 U.S. at 222-24 (single-product predatory pricing).}

One answer is that Section 2 permits "safe harbors." That is, even if Rule of Reason balancing presumptively is the default Section 2 legal test, a more defendant-friendly rule—one that creates a conclusive presumption of legality given certain facts—ought to apply in the circumstances presented.\footnote{As Werden puts it, "some potentially exclusionary conduct is appropriately placed in a prudential safe harbor, and thus is not subject to any test." Werden, \textit{supra} note 37, at 418. "Prudential safe harbors are an important adjunct to any test for exclusionary conduct, much as the per se rule is a critically important tool in the evaluation of the reasonableness of restraints of trade under Section 1 of the Sherman Act." \textit{Id.} at 418 n.21.}
The below-cost pricing requirement for predatory pricing claims is perhaps the best example. Even though above-cost pricing by a would-be or actual monopolist could make consumers worse off in some circumstances, such conduct is nonetheless lawful.\footnote{See \textit{Barry Wright Corp. v. ITT Grinnell Corp.}, 724 F.2d 227, 234-35 (1st Cir. 1983) (Breyer, J.).} The reason, courts explain, is that judicially assessing the reasonableness of above-cost pricing would chill procompetitive price cutting.\footnote{See, \textit{e.g.}, \textit{id.} at 234-36; see also Dennis W. Carlton, \textit{Market Definition: Use and Abuse}, 3 \textit{COMPETITION POLICY INT'L} 3, 12 n.12 (2007) (explicating rationale for predatory pricing safe harbor).} Thus, as long as firms do not sail out of the safe harbor by pricing below their own costs, the reasoning runs, firms can avoid the significant costs of scrutiny of their pricing strategies under Section 2, including possibly misguided damages awards imposed by unpredictable American juries.\footnote{See, \textit{e.g.}, Joshua D. Wright, \textit{Antitrust Law and Competition for Distribution}, 23 \textit{YALE J. REG.} 169, 193 & n.93 (2006).}

Although some have questioned whether the predatory pricing safe harbor serves its asserted purpose,\footnote{See, \textit{e.g.}, Paul L. Joskow & Alvin K. Kleverick, \textit{A Framework for Analyzing Predatory Pricing Policy}, 89 \textit{YALE L.J.} 213, 254 n.84 (1979) (identifying difficulties in applying cost-based tests).} many have argued it deserves emulation elsewhere in Section 2. Thus, safe harbors have been proposed for, among other conduct, "product design,"\footnote{See \textit{infra} Part III.A; see also, \textit{e.g.}, David McGowan, \textit{Between Logic and Experience: Error Costs and United States v. Microsoft Corp.}, 20 \textit{BERKELEY TECH. L.J.} 1185, 1224-25 (2005) (suggesting that the Microsoft court erred in rejecting the "market correction" approach to the government's allegations that Microsoft anticompetitively fragmented java).} refusals-to-deal,\footnote{See \textit{infra} Part III.B.} and so-called "bundled discounts."\footnote{See \textit{infra} Part III.C.} Proponents, in advancing these safe harbors, implicitly wrap themselves in the banner of \textit{Copperweld}. Safe harbors, it is asserted, should govern the conduct at issue because single-firm conduct is fundamentally different: the costs of subjecting the conduct to Rule of Rea-
son challenge are unacceptably high, including chilling the very competitive zeal that the Sherman Act is designed to promote. Viewed differently, multiplying Section 2 safe harvests is a strategy to stem the seeming erosion of Copperweld's "basic distinction" between unilateral and concerted action wrought by the rediscovery that Section 2 invokes the Rule of Reason.

My purpose here is to explore the grounds for adopting Section 2 safe harvests in light of the underlying question of whether Section 2's liability framework should be fundamentally different than Section 1's. My premise is that the debate over whether single-firm and concerted conduct as a general matter properly are subject to different liability tests—that is, over the meaning of Copperweld—is misguided. The reason is that Section 2's Rule of Reason is flexible enough to encompass many articulations. The Rule of Reason is not simply a specific legal test that requires balancing anticompetitive effects against procompetitive justifications and considering less restrictive alternatives, but rather more generally supplies a principle by which courts generate legal tests in a common-law fashion. Section 2's Rule of Reason commands the federal courts to identify the legal test that, for the conduct in question, makes competition and consumers better off relative to applying some other legal test to that conduct. Put differently, the "balancing" the Rule of Reason requires can be, and as demonstrated below frequently is, performed at the level of selecting the governing Section 2 legal test; that legal test may (or may not) call for case-specific balancing or some other analysis.

This understanding of Section 2's Rule of Reason has implications for the practical question of whether courts should adopt other Section 2 safe harvests (in the sense of legal tests having the property that, when certain factors are present, the conduct is lawful under Section 2 without further scrutiny). Section 2 safe harvests are not some exception to the Rule of Reason, but rather applications of the Rule of Reason for the conduct in question. Safe harvests, as with any articulation of the Rule of Reason, must be demonstrated superior to alternative legal tests, because the safe harbor can be expected to produce lower error and enforcement costs when applied to the conduct in question than a different legal test. Understanding that safe harvests ought to be created by the same common-law process and justified by the same factors as any other Section 2 legal test, moreover, gives sharper focus to the considerations that courts ought to consider when adopting safe harvests, including: (1) Is the conduct discrete or heterogeneous?; (2) Can a categorical judgment be reached as to the conduct's likely impact on competition and consumer welfare?; (3) Is the proposed safe harbor administrable relative to either the otherwise applicable (default) or other candidate legal tests?; (4) Would the adopted safe harbor undesirably spill over to closely-related conduct?; and (5) Is application of the safe har-

51 See, e.g., Rule, supra note 12, at 4-7.
bor likely materially to reduce "false positives" (that is, wrongly condemning conduct that may benefit consumers) without causing excessive "false negatives" (that is, wrongly exonerating conduct that may harm consumers) or exacerbating enforcement costs?

Accordingly, Part I below explains how courts employ Sherman Act Section 2's Rule of Reason to identify appropriate Section 2 legal tests. Part II develops the implications of Section 2's Rule of Reason for crafting safe harbors. Part III applies the framework elaborated in Part II to three areas where Section 2 safe harbors are frequently proposed: product design, refusals to deal, and bundled discounts. I conclude that, when a court confronts a request to adopt a safe harbor, it must not be too quick to assume that a balancing test otherwise would govern the conduct's legality and, for that reason, adopt the safe harbor. The choice is not a binary one between extremes; rather, Section 2's Rule of Reason instead might point toward adopting a different legal test that better serves the interests of competition and consumers. Put differently, although—as Copperweld instructs—Section 2's legal test is more stringent than Section 1's at least because single-firm conduct must threaten actual monopolization to trigger the Sherman Act, that is not the only permissible distinction in how the Rule of Reason applies to unilateral and concerted conduct. What other distinctions courts should draw depend on a context-specific analysis that courts must conduct with care.

I. WHERE DO SECTION 2 LEGAL TESTS COME FROM?

Evaluating a safe harbor requires knowing what legal test otherwise governs. As noted, many Section 2 safe-harbor proposals presume that Rule of Reason balancing otherwise would govern the conduct.52 A safe harbor, it is argued, is far better for competition and consumers than Rule of Reason balancing, which threatens to chill procompetitive conduct even if the defendant is already a monopolist.53

The assumption behind this justification for safe harbors—that a balancing test must govern all unilateral conduct absent an exception—is misconceived. Courts since Microsoft have asserted, with astonishingly little

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52 The assumption that Rule of Reason balancing governs absent a safe harbor is implicit, for example, in the Antitrust Modernization's Commission's analysis of "bundled discounts" under Section 2. See generally ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS 94-101 (2007) [hereinafter AMC REPORT], available at http://govinfo.library.unt.edu/amc/report_recommendation/chapter1.pdf; see also, e.g., Jonathan M. Jacobson, Exploring the Antitrust Modernization Commission's Proposed Test for Bundled Pricing, ANTITRUST, Summer 2007, at 26 (characterizing the AMC's "harm to competition" back-stop to proposed safe harbor as "a basic rule of reason test").

53 See, e.g., Jacobson, supra note 52, at 27 (arguing that abandoning the AMC's proposed safe harbor would "deter many beneficial pricing strategies"); Melamed, supra note 32, at 389-95 (critiquing balancing and advocating sacrifice test in part on this ground).
dissent, that Section 2 requires applying the Rule of Reason. Nevertheless, it would be misleading to read these decisions to compel applying the Rule of Reason in the narrow sense of a specific legal test that balances anticompetitive effects and procompetitive justifications. Rather, Section 2’s Rule of Reason, just like Section 1’s, is more fundamentally a principle that guides that statute’s common-law elaboration. Section 2’s Rule of Reason directs courts to develop Section 2 legal tests by determining, for the conduct in question, the legal test that on balance is best for competition and consumers relative to other legal tests. Put differently, the Rule of Reason permits the balancing of procompetitive and anticompetitive consequences in light of enforcement costs and other factors not only in determining the consequences of particular conduct, but also in selecting the legal test to govern that conduct.

As developed more fully elsewhere, this more fundamental understanding of the Rule of Reason—as a principle for generating appropriate legal tests—is demonstrated by four inter-related observations:

(1) Section 2 is not, as a descriptive matter, “one size fits all.” Rather than employ a unitary test, courts have applied a variety of legal tests to the heterogeneous conduct subject to Section 2. These tests include, among others, rules of per se legality, cost-based tests, the profit-sacrifice tests, balancing tests, certain special tests (such as for sham litigation), and rules of near per se illegality if the defendant is a monopolist and engages in the forbidden conduct. Indeed, in launching the U.S. antitrust agencies’ recent hearings on Section 2 of the Sherman Act, former Federal Trade Commission (“FTC”) Chairman Majoras recognized that the diversity of conduct subject to Section 2 “may mean there can be no unitary test, or that we simply need a broad framework that can accommodate a spectrum or sliding scale for levels of likelihood of competitive harm.”

(2) Disparate Section 2 legal tests can be arranged on a spectrum according to the level of “intervention” (how plaintiff- or defendant-friendly is the test?). The resulting spectrum of Section 2 legal tests ranges from

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54 See supra note 31 and accompanying text. Some pre-Microsoft courts applied Rule of Reason analysis under Section 2. See Mid-Texas Commc’ns. Sys., Inc. v. AT&T Co., 615 F.2d 1372, 1389 n.13 (5th Cir. 1980) (“It is clear, however, that the analysis under section 2 is similar to that under section 1 regardless whether the rule of reason label is applied per se.” (citing Byars v. Bluff City News Co., 609 F.2d 843, 860 (6th Cir. 1979))).

55 See Popofsky, supra note 33, at 453-56.

56 Id.

57 See id. at 457.

58 See generally id. at 448-56.

59 See id. at 441-42 (describing distinct legal tests).

Alcoa's rule of per se legality for setting a high price to rules of near per se illegality for certain monopolizing "dirty tricks." Moreover, a greater level of intervention appears to correspond to a reduced threat of false positives, and an increased threat of false negatives, from applying the indicated legal test rather than some other legal test. Put differently, the indicated legal test for the conduct in question can be expressed as the legal test that best "balances" (more precisely, seeks to minimize) the competing considerations of error and enforcement costs.

(3) Key Section 2 decisions make plain that minimizing error and enforcement costs is the touchstone for crafting appropriate Section 2 legal tests. Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP provides a recent example. The Court assessed whether "traditional antitrust principles" warranted recognizing a duty to deal in the circumstances by "weigh[ing] a realistic assessment of [antitrust scrutiny's] costs" against what it found to be "slight benefits of antitrust intervention." Concluding that "[t]he cost of false positives counsels against an undue expansion of § 2 liability," the Court rejected the plaintiff's proposed legal test. Trinko, moreover, expressly invoked then-Judge Breyer's decision in Town of Concord v. Boston Edison Co. There, the court explained that, to label conduct exclusionary, "one must believe that the anticompetitive risks associated with [it] outweigh the possible benefits and the adverse administrative considerations." In other words, in deciding which legal test to adopt, Section 2 courts must apply a Rule of Reason. Then-Judge Breyer expressly made this connection between the Rule of Reason and Section 2 in another famous decision, Barry Wright. If the "challenged conduct is not 'exclusionary' for purposes of Sherman Act § 2, then a fortiori it does not violate

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61 Popofsky, supra note 33, at 441 (diagram of spectrum).
62 Id. at 450-51.
63 Id. at 457; see also, e.g., Rule, supra note 12, at 15 ("Section 2 rules should be developed and implemented with a focus on avoiding false positives and minimizing administrative and uncertainty costs.").
64 See generally Popofsky, supra note 33, at 452-53.
66 Id. at 411, 414.
67 Id. at 414, 416.
68 Id. at 412 (citing Town of Concord v. Boston Edison Co., 915 F.2d 17 (1st Cir. 1990) (Breyer, C.J.).
69 Town of Concord, 915 F.2d at 25; see also id. (holding that "a price squeeze in a fully-regulated industry . . . will not normally constitute 'exclusionary conduct' under Sherman Act § 2"). As of the date of this Essay, the Supreme Court is poised to decide whether a price squeeze is exclusionary when the defendant, it is assumed, has no antitrust duty to deal with the plaintiff in the wholesale market and charges prices above cost in the retail market. See linkLine Commc'ns, Inc. v. SBC California, Inc., 503 F.3d 876 (9th Cir. 2007), cert. granted sub nom. Pacific Bell Tel. Co. v. linkLine Commc'ns, Inc., No. 07-512, 2008 WL 2484729 (U.S. June 23, 2008).
70 See Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 239 (1st Cir. 1983) (Breyer, J.).
the other provisions” of the antitrust laws.\textsuperscript{71} Put more crisply, “conduct that is not ‘exclusionary’ is not ‘unreasonable’”;\textsuperscript{72} and

(4) Recognition that Section 2 invokes the Rule of Reason does not invariably lead courts to engage in a case-specific balancing of anticompetitive effects against procompetitive justifications. For example, the Microsoft court privileged Microsoft’s development and marketing of its IE Access Kit and creation of certain incompatibilities between its Java Virtual Machine (“JVM”) and Sun’s JVM, even though those acts hindered rivals.\textsuperscript{73} The conduct, the court reasoned, was not anticompetitive.\textsuperscript{74} By refusing to “balance” long-term competitive harm against other effects in these circumstances, the Microsoft court implicitly acknowledged that the Rule of Reason does not always require balancing. The appropriate test for “reasonableness” can vary with the circumstances.\textsuperscript{75}

The insight that Section 2’s Rule of Reason may have different expressions is, of course, only the beginning, and not the end, of the common-law process. Courts must identify, for the conduct at issue, the legal test that best serves the interests of competition and consumers. Put differently, as Trinko and Town of Concord teach, the expression of the Rule of Reason that governs conduct is the legal test that minimizes error and enforcement costs relative to applying other legal tests to that conduct.\textsuperscript{76}

To identify the right Section 2 legal test in principle requires a lot of information. Among other things, the court must determine: (1) Is the conduct at issue really distinguishable from other conduct, such that two coherent categories exist that warrant distinct legal treatment?; (2) What are the likely competitive consequences of that category of conduct?; (3) Would applying one legal test as opposed to another reduce or increase the risks of false positives and false negatives?; (4) Are courts likely to have the information needed to apply candidate legal tests accurately?; (5) Is a clear rule, which may be under- or over-inclusive, preferable to a more inclusive yet

\textsuperscript{71} Id.
\textsuperscript{72} Id.
\textsuperscript{73} See United States v. Microsoft Corp., 253 F.3d 34, 74-75 (D.C. Cir. 2001) (en banc) (per curiam).
\textsuperscript{74} Compare id. at 68, 74-75 (rejecting Internet Explorer Access Kit and Java Virtual Machine challenges) with Barry Wright Corp., 724 F.2d at 233-36 (rejecting challenge to above-cost pricing even though in some circumstances such “price cutting might not be procompetitive and might, in theory, hurt the consumer” (citing Transamerica Computer Corp. v. Int’l Bus. Machs. Corp., 698 F.2d 1377, 1387 (9th Cir. 1983))).
\textsuperscript{75} See Popofsky, supra note 33, at 453-56.
\textsuperscript{76} See Trinko, 540 U.S. at 414 (concluding that courts should “weigh a realistic assessment of [antitrust’s] costs” against “the slight benefits of antitrust intervention” in selecting legal rules); Town of Concord v. Boston Edison Co., 915 F.2d 17, 25 (1st Cir. 1990) (Breyer, C.J.) (arguing that conduct is exclusionary when “the anticompetitive risks associated with [the conduct] outweigh the possible benefits and the adverse administrative considerations”).
less-predictable standard?; (6) Which legal test is easier to apply?; and (7) Would creating a discrete legal test to govern the conduct in question distort commercial behavior by encouraging firms inefficiently to shift to conduct governed by a more lenient legal test?

If courts had to investigate and answer these questions anew in every Section 2 case, the burden might be substantial, and the transactions costs involved might exceed the benefits to the system of antitrust enforcement. Fortunately, the common-law process of developing Section 2 does not take place on a clean slate. For one thing, default legal tests govern certain categories of conduct; that is, a particular test applies unless persuasive reasons can be shown to apply another doctrine. The Rule of Reason in the sense of case-specific balancing is such a default test. For another, the appropriate Section 2 legal test (or at least its broad parameters) is settled as a matter of stare decisis for some categories of conduct. Brooke Group’s cost-based test for single-product predatory pricing is one such example. Town of Concord’s special rule for price squeezes in a regulated industry is another.

The existence of background legal tests greatly aids courts’ tasks because such tests provide a starting point for the analysis, a baseline against which to assess whether a different legal test is warranted, and a legal test to fall back on when the answers are unsatisfactory. Barry Wright provides a prime example. There, the court assessed a predatory-pricing claim where, it was conceded, prices were not set below cost. Drawing on a well-developed body of law and commentary, the court reasoned that requiring below-cost pricing for illegality provided the appropriate background legal framework for assessing this claim. The court then assessed whether it should recognize an “exception” to the requirement of below-cost pricing when “the anticipated benefits of the defendant’s price depended on its tendency to discipline or eliminate competition” (i.e., apply the “no economic sense” or “profit sacrifice” test instead). The court acknowledged that the plaintiff’s proposal “recognize[d] a circumstance in

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77 See Popofsky, supra note 33, at 466-68.
80 Weyerhaeuser v. Ross-Simmons Hardwood Lumber Co., 127 S. Ct. 1069 (2007), also provides a recent example. In assessing the correct legal test to apply to a predatory-bidding scheme, the Weyerhaeuser Court recognized that Brooke Group supplied the appropriate baseline legal test because “[p]redatory-pricing and predatory-bidding claims are analytically similar.” Id. at 1076-77. The Court then adapted the two prongs of the Brooke Group test to fit distinct circumstances presented by predatory-bidding schemes. Id. at 1078.
81 See Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 230-31 (1st Cir. 1983) (Breyer, J.).
82 See id. at 232-33.
83 Id. at 233 (quoting William Inglis & Sons Baking Co. v. ITT Cont’l Baking Co., 668 F.2d 1014, 1035 (9th Cir. 1981)).
which even ‘above total cost’ price cutting might not be procompetitive and might, in theory, hurt the consumer.” The court nonetheless rejected creating an exception to a cost-based test because:

[W]hile technical economic discussion helps to inform the antitrust laws, those laws cannot precisely replicate the economists’ (sometimes conflicting) views. For, unlike economics, law is an administrative system the effects of which depend upon the content of rule and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they are designed to serve. . . . [W]e must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition.

Put in terms of the framework advanced here, recognizing an exception to the below-cost predatory pricing rule would not further reduce error and enforcement costs. The conduct is difficult to categorize; a “disciplinary [price] cut’ is difficult to distinguish in practice” from a benign above-cost price reduction. The proposed exception would also be difficult to apply, thereby increasing potential error costs: “its presence may well be ‘wrongly’ asserted in a host of cases involving legitimate competition”; and “to allow its assertion threatens to ‘chill’ highly desirable procompetitive price cutting.” On the other side of the ledger, the court concluded, the benefits to consumers of permitting the exception when properly advanced would not be great, for the anticompetitive impact would be restricted to “injur[ies] only [to] higher cost competitors.” In other words, recognizing an exception to the below-cost rule would not on balance make consumers in the long-run better off, even if adherence to that rule meant that some competitively-harmful price cuts went unchallenged.

II. WHERE SHOULD SAFE HARBORS COME FROM?

Understanding the relationship between the Rule of Reason and Section 2 legal tests casts safe harbors in a new light. First, safe harbors, however defined, are not some exception to the Rule of Reason. Rather, when justified, safe harbors represent the expression of the Rule of Reason appropriate in the circumstances. The legal test the safe harbor embodies, properly understood, is the “enquiry meet for the case.” Thus, safe harbors are no different in principle from other Section 2 legal tests, which also

84 Id. (citing Transamerica Computer Corp. v. IBM Corp., 698 F.2d 1377 (9th Cir. 1983)).
85 Id. at 234 (citations omitted).
86 Id. at 235.
87 Barry Wright Corp., 724 F.2d at 235-36.
88 Id. at 235.
reflect different elaborations of the same underlying Rule of Reason: apply the legal test that for the conduct in question minimizes the sum of error and enforcement costs.  

Second, exposing the dichotomy between Rule of Reason and safe harbor as false is not merely semantic; it is substantive. Safe harbors are often proposed based on the premise that the alternative is the Rule of Reason in the sense of an open-ended, case-specific balancing test. Because, the argument runs, the Rule of Reason’s balancing test can be difficult to apply, sweeps in a variety of factors, and provides potential defendants with little guidance as to when their conduct crosses the line from lawful competition to illegal exclusion, safe harbors are clearly a superior alternative.

The premise of a single alternative is false. Under Section 2’s Rule of Reason, as explained, courts are not restricted in their choices to a conclusive presumption safe harbor (e.g., a rule of per se legality in the presence or absence of certain facts) and full-blown balancing. Courts are free, rather, to chart an intermediate course and employ the legal test that best serves the interests of competition and consumers relative to applying a different legal test. It may turn out that, upon analysis, the appropriate legal test is neither full-blown balancing nor a rule of per se legality in the presence of certain facts, but perhaps something in between. There is no shortage of intermediate points between full-blown balancing and, for example, a rule that a product design decision is per se lawful if the putative monopolist can demonstrate any benefit (to itself or others) from a design decision. To be sure, the Rule of Reason in the narrow sense of a balancing test may in some circumstances supply the appropriate background legal test against which courts compare competing legal tests. But that is only a starting point for the analysis, not the end.

Third, in considering the adoption of a safe harbor, as when crafting any other Section 2 legal test, courts must proceed practically, keeping in mind the fundamental limitations of the common-law system by which U.S. antitrust law is created and enforced, and the relative benefits of competing types of legal tests. These include, among other considerations, the following:

1) Courts must predict the competitive consequences of conduct, and the impact of selecting one legal test over another, in the presence of imperfect information. This creates, as a practical matter, a presumption in favor of the background legal test that otherwise governs the conduct. For some conduct, that background test may well be “balancing.” For other conduct, it might be a cost-based test. For yet other conduct, it might be the “no eco-

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90 See supra text accompanying notes 52-74.
91 See supra notes 52-53 and accompanying text.
92 See supra notes 54-60 and accompanying text.
93 See supra text accompanying notes 64-72.
nomic sense” test, the predatory pricing test, or even a rule of per se legality;

(2) Categorization is costly and requires characterization. To justify a safe harbor for a particular class of conduct requires courts to distinguish that conduct from other conduct. Just as finding an “agreement” or characterizing the relevant conduct as “unilateral” is not always straightforward, so too determining whether a safe harbor applies to the conduct is not always self evident. This means that courts must pay special attention to whether the conduct at issue can meaningfully be distinguished from other conduct that is properly subject to a different legal test;

(3) Relatively, courts must be particularly sensitive to problems of spillover and moral hazard. A safe harbor created with certain conduct in mind might be read by subsequent courts to sweep in other conduct, even though the rationale for the safe harbor might not properly apply to that other conduct. There are practical limits to courts’ ability to ameliorate this problem through foresight and greater precision in defining the class of conduct covered by the legal test. Moreover, the narrower the conduct a safe harbor covers, the greater the problem of firms possibly substituting to less efficient conduct to avoid application of an undesired legal framework; and

(4) Whether the appropriate legal test should take the form of a “rule” or a “standard” is sensitive to context. Rules, all else equal, can be less costly to enforce, but carry with them the risk of greater costs from over- or under-inclusion (that is, costs from false negatives and false positives that stem from the legal test’s content, as opposed to vagaries in its application). This is both because substantial information and resources must be expended to get a rule “right” and because crafting a rule involves making choices concerning what the rule covers and prohibits. Standards, by contrast, can be more costly to enforce and may result in greater error costs (that is, costs from a case-specific error in application) than a corresponding rule.

The combined effect of the above is that courts must consider the relative heterogeneity and frequency of the conduct when selecting appropriate Section 2 legal tests, including safe harbors. The more homogenous the

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94 See supra accompanying text notes 13-25.
97 Id. at 265-68.
98 Id. at 265; Kaplow, supra note 95, at 562 (“[S]tandards are more costly for legal advisers to predict or enforcement authorities to apply because they require later determinations of the law’s content.”).
99 Popofsky, supra note 33, at 459.
conduct and the clearer its competitive consequences, the more easily the conduct is functionally distinguishable from other conduct, and the more frequently-encountered the conduct, the greater the justification for creating a specialized rule. When all these factors point in the same direction, there may be justification, as there was for example in Barry Wright, for adopting a safe harbor. \(^{100}\) By contrast, where some or all of the factors point in the other direction, courts should consider expressions of Section 2's Rule of Reason that leave room for exceptions. At the extreme, where conduct is heterogeneous, its competitive effects less well understood, and the costs of rules unclear, a standard (such as Rule of Reason balancing) may well be superior to a rule.

III. THREE KEY POINTS OF CONTEMPORARY DEBATE FOR UNILATERAL CONDUCT

The practical question for the courts is what the Rule of Reason as the lodestar for elaborating Section 2 means for deciding whether to adopt safe harbors for certain classes of unilateral conduct. I do not propose to answer that question completely here. Instead, I offer the following observations for three areas where safe harbors are frequently suggested (and by some courts adopted).

A. Product Design

Various safe harbors have been proposed for "product design." For example, in the Microsoft litigation, Microsoft argued for a test under which the existence of any benefit from "product design" would place that conduct beyond the reach of Section 2.\(^{101}\) Others have made similar calls for lenient treatment of product design (or, more narrowly, product "innovation" absent bundling).\(^{102}\) The rationale behind all these relatively defen-

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\(^{100}\) See, e.g., Carlton, *supra* note 45, at 12 n.12 ("Choosing the appropriate safe harbor is an exercise that should depend on the frequency with which the practice is used in ways that harm society compared to its frequency of use in ways that benefit society, the ability of courts to identify the two uses, the harms from incorrect identifications, and the benefits from correct identifications.").

\(^{101}\) See Reply Brief for Defendant-Appellant at 28, United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001) (No. 00-5212), 2001 WL 36047065 ("[D]esign changes that improve a product cannot violate Section 2, regardless of the defendant's intent." (citing Transamerica Computer Corp. v. IBM Corp., 481 F. Supp. 965, 1005 (N.D. Cal. 1979))).

\(^{102}\) See Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 320 (2003) ("Where [product design] does have an efficiency justification ... that alone suffices to make the conduct legal without further inquiry into its possibly adverse effects on overall market efficiency."); 3A *PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW* ¶ 781(e), at 271 (2d ed. 2001) ("We therefore conclude that all product innovation should be lawful in the absence of bundling, setting aside..."
dant-friendly tests is straightforward: consumers reap great benefits from innovation, perhaps greater than from static price competition.\textsuperscript{103} Antitrust scrutiny of product design is likely to produce erroneous decisions and deter procompetitive conduct. Antitrust courts therefore should put a weight on the scale in favor of permitting innovative activity even if it carries some risk of reducing long-term competition by hindering rivals.

Courts, however, have resisted adopting explicit safe harbors for product design. \textit{Microsoft}, for example, nominally applied a Rule of Reason framework to product-design decisions.\textsuperscript{104} So too did a number of decisions, both before\textsuperscript{105} and since.\textsuperscript{106} Although many of these cases appear to turn on the existence of a justification for the conduct, and thus in practice applied something close to a “no economic sense” framework,\textsuperscript{107} it is nonetheless striking that courts thus far have resisted protective screens. Indeed, \textit{Microsoft} went out of its way to stress that “[j]udicial deference to product inno-

\textsuperscript{103} Jorde & Teece, \textit{supra} note 28, at 580 (“The most important kind of competition—at least the competition that society should really care about—is driven by innovation and technological change, leading to the introduction of new products, processes, and technologies.”); \textit{id.} at 600 (“The societal gains from the development and commercialization of innovation are often enormous and generally far exceed the gains derived from static allocative efficiency.”); \textit{see also} Joseph F. Brodley, \textit{The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress}, 62 N.Y.U. L. REV. 1020, 1026-27 (1987).

\textsuperscript{104} See \textit{Microsoft}, 253 F.3d at 65-67.

\textsuperscript{105} See Popofsky, \textit{supra} note 33, at 446 & nn.57-59 (citing cases); \textit{see also} Transamerica Computer Co. v. IBM Corp., 698 F.2d 1377, 1382 & n.2 (9th Cir. 1983); GAF Corp. v. Eastman Kodak Co., 519 F. Supp. 1203, 1227-28 (S.D.N.Y. 1981) (“[I]n scrutinizing design conduct, § 2 would merely require the monopolist’s design to be ‘reasonable,’ rather than to be the design alternative least restrictive of competition.”).

\textsuperscript{106} See Xerox Corp. v. Media Scis. Int’l, Inc., 511 F. Supp. 2d 372, 389 (S.D.N.Y. 2007) (“[I]f Xerox presents evidence that the modifications improved the product or otherwise served valid business reasons, then the Court or a jury may have to weigh these justifications against the alleged anticompetitive effect.”); Abbott Labs. v. Teva Pharm. USA, Inc., 432 F. Supp. 2d 408, 422 (D. Del. 2006).

\textsuperscript{107} See, e.g., C.R. Bard, Inc. v. M3 Sys., Inc., 157 F.3d 1340, 1382-83 (Fed. Cir. 1998) (Bryson, J., concurring in part and dissenting in part) (opinion for court on antitrust claims).
vation... does not mean that a monopolist’s product design decisions are per se lawful.\textsuperscript{108}

The framework advanced here may explain courts’ caution. Product design is not a self-defining term. That elastic concept covers—and, importantly, could be stretched to cover—a wide range of activities. The decision of a computer hardware manufacturer to employ one interface design rather than another involves product design. So, too, does a software vendor’s decision to construct files to contain certain code. But where does the concept end? Does “product design” extend, for example, to every aspect of a software program’s functionality—such as to a new program that combined previously separately-offered products? If so, is a manufacturer’s decision to sell nuts and bolts together in the same package a “product design” decision? What of a drug manufacturer’s decision to combine two previously-separate medications in a single multi-purpose pill? Product design is understood to imply innovative activity relating to product attributes; but where to draw the line (in the above example, between product design and bundling) can be elusive.

The difficulty in defining product design is conjoined with a vigorous debate over whether such conduct, even at the core of the product design concept, poses substantial antitrust risks and the extent to which antitrust scrutiny is likely to chill desirable innovative efforts. Broad agreement exists that consumers derive substantial benefits from innovation; indeed, many argue, innovation provides greater benefits to consumers than promoting productive or allocative efficiency.\textsuperscript{109} But there is substantial disagreement over whether the prospect of market power, or greater rivalry, best spurs innovation.\textsuperscript{110} Similarly, although many argue that durable market power in fast-moving high technology industries is rare, and thus long-term anticompetitive consequences from possibly anticompetitive acts is unlikely, others disagree, contending that network effects or other entry barriers can enable lasting anticompetitive consequences from exclusionary acts.\textsuperscript{111}

\textsuperscript{108} Microsoft, 253 F.3d at 65. \textit{But cf.} Medtronic Minimed Inc. v. Smiths Med. MD Inc., 371 F. Supp. 2d 578, 587-89 (D. Del. 2005) (rejecting challenge to product design decision due to lack of substantial anticompetitive effect but stressing that to accept plaintiff’s claim—that defendant ought to have used a less restrictive design—would undermine incentives to innovate).

\textsuperscript{109} Brodley, supra note 103; Jorde & Teece, supra note 28, at 580, 600.

\textsuperscript{110} See Michael L. Katz & Howard A. Shelanski, \textit{Mergers and Innovation}, 74 ANTITRUST L.J. 1, 17-21 (2007) (explicating the Schumpeterian view that “most technological innovation would come from large corporations with market power” but noting that some analyses have “found data to show concentration to have a negative effect on innovation”). \textit{Cf.} Mark A. Lemley, \textit{Property, Intellectual Property, and Free Riding}, 83 TEX. L. REV. 1031, 1068 (2005) (“[A]dding more and more intellectual property protection not only has diminishing marginal benefits, but at some point has a net negative impact on innovation...”).

\textsuperscript{111} Compare David J. Teece & Mary Coleman, \textit{The Meaning of Monopoly: Antitrust Analysis in High-Technology Industries}, 43 ANTITRUST BULL. 801, 813 (1998) (“[A]ny dominance is likely to be
In other words, the difficulty in creating crisp categories that differentiate product design from other conduct, the heterogeneity of the activities covered by the concept, and the lack of consensus concerning the relative costs of false positives and false negatives appear to underlie courts’ resistance to adopting safe harbors for conduct that can be labeled product design. Instead, as a practical matter, it appears courts look for a significant anticompetitive effect or a substantial justification within a Rule of Reason balancing framework.\footnote{See sources cited supra notes 104-08.} To be sure, conduct-specific legal tests may properly govern product design in some circumstances. For example, in Microsoft, the court declined to apply tying law’s per se rule to a certain class of tying arrangements involving “design” decisions.\footnote{See Microsoft, 253 F.3d at 89-95.} But in doing so, the court narrowed an otherwise applicable per se rule of illegality in favor of a more inclusive Rule of Reason analysis. To justify a less inclusive rule of per se legality for product design, courts likely will demand a far more rigorous demonstration of a safe harbor’s relative benefits than thus far have been advanced.

B. Unilateral Refusals to Deal with Rivals

Another area often suggested as appropriate for safe harbors is unilateral refusals to deal by an actual or would-be monopolist. The possibility of a discrete liability rule for refusals to deal is suggested by the seminal Colgate decision: “In the absence of any purpose to create or maintain a monopoly, the act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal; and, of course, he may announce in advance the circumstances under which he will refuse to sell.”\footnote{United States v. Colgate & Co., 250 U.S. 300, 307 (1919).}

Subsequent case law similarly has not applied a Rule of Reason balancing test to a monopolist’s refusal to deal. Cases recognizing the essential facility doctrine require a plaintiff to meet several prerequisites before the doctrine is implicated. For example, under MCI, invoking the essential facilities doctrine requires showing: “(1) control of the essential facility by a monopolist; (2) a competitor’s inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility.”\footnote{E.g., MCI Commc’ns Corp. v. AT&T Co., 708 F.2d 1081, 1132-33 (7th Cir. 1983).} To be sure, some
of these elements implicate a “reasonableness” inquiry. Whether, for instance, sharing is “feasible,” the facility can “reasonably” be duplicated, and even determining whether there is a “denial,”116 can involve balancing competing interests and not bright lines. But the legal framework is plainly not balancing.

The Supreme Court’s recent refusal-to-deal jurisprudence, too, has eschewed balancing in the narrow sense of a case-specific balancing test. In Trinko, the Court made plain that a refusal-to-deal is not to be tested by a plenary balancing of anticompetitive effects against efficiencies: the Sherman Act, the Court stated, “does not give judges carte blanche to insist that a monopolist alter its way of doing business whenever some other approach might yield greater competition.”117 Instead, as explained, Trinko engaged in balancing at the stage of deciding what legal test should govern the conduct, and concluded that no new exception to Colgate ought to be created in the circumstances presented.118 Trinko thus confirms that Aspen’s invocation of the Rule of Reason in describing exclusionary conduct was not meant to require case-specific balancing in all Section 2 cases.119

Yet, Trinko did not create a safe harbor for refusals to deal. This was despite the urging of amicus curiae that the Court adopt the so-called “profit sacrifice” test.120 Under some versions of the proposed legal test, a monopolist’s refusal to deal could be unlawful only if the monopolist would make less money by the refusal than by dealing. Aspen, after all, involved a profit sacrifice (evidenced by terminating a voluntary course of dealing and refusal to sell at retail prices available to others).121 But instead of adopting the profit-sacrifice test as a necessary condition for Section 2 liability (a safe harbor of sorts), the Trinko court reasoned that the absence of a profit sacrifice on the facts before it “shed no light upon the motivation of [the]

118 See id. at 411-16.
119 The Supreme Court in Aspen Skiing Co. stated: “Thus, ‘exclusionary’ comprehends at the most behavior that not only (1) tends to impair the opportunities of rivals, but also (2) either does not further competition on the merits or does so in an unnecessarily restrictive way.” Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 n.32 (1985) (quoting 3 Phillip E. Areeda & Donald F. Turner, Antitrust Law ¶ 626b, at 78 (1978)). See Popofsky, supra note 33, at 438-40, for a discussion of this passage. See also Andrew I. Gavil, Exclusionary Distribution Strategies By Dominant Firms: Striking a Better Balance, 72 Antitrust L.J. 3, 21 (2004) (“Aspen does not directly answer the question” of “what is the proper approach to assessing dominant firm conduct under Section 2 when it produces both anticompetitive effects on rivals and consumers (i.e., inefficiencies) and procompetitive effects for the alleged excluding firm (i.e., efficiencies)?”). See Salop & Romaine, supra note 27, at 650-51, for a contrary view.
121 Aspen, 472 U.S. at 608-11.
refusal to deal—upon whether its regulatory lapses were promoted not by competitive zeal but by anticompetitive malice."\textsuperscript{122}

This surprising and anachronistic echoing of \textit{Colgate}'s focus on anticompetitive intent has left the precise test that governs refusals to deal unclear. In \textit{Trinko}'s wake, commentators have proposed a number of discrete rules to govern refusals to deal. Some argue for application of a Rule of Reason balancing test, although one that assertedly protects investment incentives by not condemning a refusal to deal below a certain benchmark except in extraordinary circumstances.\textsuperscript{123} By contrast, some assert that a profit-sacrifice test, if passed, should provide a safe harbor for refusals to deal with rivals.\textsuperscript{124} There is, moreover, significant disagreement as to how to conduct a profit-sacrifice test in a refusal-to-deal context. Should the test protect all preexisting monopoly profits or only a portion?\textsuperscript{125} Finally, at least one court has read \textit{Trinko} to erect a safe harbor when the refusal (unlike \textit{Aspen}) does not involve terminating a prior course of dealing.\textsuperscript{126}

The case for crafting safe harbors for refusals to deal with rivals is arguably stronger than for product design. First, the conduct at issue is circumscribed and well-defined. Although certain conduct can raise conceptually difficult issues,\textsuperscript{127} in general we know a refusal to deal when we see it. Second, the conduct—refusing to share one's property with rivals—is discrete. Third, there is a general consensus that compelling firms to share their property with rivals, regardless of whether those rivals operate in the same market or a downstream market, can undermine incentives to innovate and compete.\textsuperscript{128} There is force to the argument that the risk of courts "getting it wrong" in this area is high and, thus, so too are the costs of false positives.

Still, before courts erect a safe harbor for refusals to deal, they must identify the background legal test and assess alternatives. \textit{Trinko}'s focus on "intent," arguably the applicable background legal test \textit{Colgate} supplies,

\textsuperscript{122} \textit{Trinko}, 540 U.S. at 409.

\textsuperscript{123} See, e.g., Salop, supra note 31, at 7-12.

\textsuperscript{124} See, e.g., Melamed, supra note 29, at 1264-65.

\textsuperscript{125} See Salop, supra note 27, at 14-15.

\textsuperscript{126} \textit{See In re Elevator Antitrust Litig.}, 502 F.3d 47, 53-54 (2d Cir. 2007). In Europe, there is no safe harbor even for refusals to deal involving intellectual property as the Court of First Instance's decision in Microsoft Corp. illustrates. Case T-201/04, Microsoft Corp. v. Comm'n of the European Communities, 2007 WL 2693858 (Sept. 17, 2007), at ¶¶ 332-33 (describing "exceptional" circumstances that give rise to an abuse of a dominant position by refusing to license intellectual property). The Court went on to find exceptional circumstances based on the facts of the case. Id. ¶¶ 620, 665, 688-712.

\textsuperscript{127} These include, to give an earlier-described example, distinguishing a refusal to deal conditioned on engaging in conduct (and acquiescence) from an agreement to engage in the conduct. \textit{See supra} text accompanying notes 13-16.

\textsuperscript{128} \textit{See}, e.g., Phillip Areeda, \textit{Essential Facilities: An Epithet in Need of Limiting Principles}, 58 \textit{ANTITRUST L.J.} 841, 851 (1989) ("Required sharing discourages building [new] facilities . . . even though they benefit consumers.").
hardly provides clear guidance; for it is unclear when a firm’s refusal to
deal with rivals crosses the line from “competitive zeal” to “anticompetitive
malice.” The profit-sacrifice test may be a useful rule of inclusion (i.e., it
indicates circumstances meriting further inquiry); but adopting it as a safe
harbor raises a range of further issues, including: (1) Which competition-
harming refusals to deal would remain unredressed if legality turns on the
absence of a profit sacrifice?; (2) What are the likely costs to competition
and consumers of not applying a different legal test (e.g., perhaps a
weighted balancing test, where anticompetitive effect must clearly out-
weigh the adverse impact on incentives to innovate and other factors) to
such conduct?; (3) Is there a substantial risk of the rule’s undesired exten-
tion to refusals to deal with customers?; and (4) Is the profit-sacrifice test
any easier to apply, or predict, than alternative legal tests? These are the
questions that post-Trinko courts should ask.

C. Bundled (or Conditioned) Discounts

Bundled or conditioned discounts present the area in which the stakes
in the safe harbor debate are perhaps the highest. Bundled discounts de-
scribe a diverse array of practices, many common in competitive markets.
In the case of single products, the concept includes volume- and market-
share discounts. In the case of multiple products, conditioned discounts
include, among other conduct: discounts for meeting increased sales targets
when purchasing from multiple divisions, part of the conduct held to violate
Section 2 in LePage’s; “economic” tie-ins, whereby one product is func-
tionally unavailable separately because steep discounts for it are condi-
tioned on taking a separate product; and innumerable variations on these
themes.

Although describing a fairly wide swath of pricing practices, there is a
core “bundled discounting” case that can raise competitive concerns: when
a firm conditions discounts on a monopoly product on customers taking

130 See generally Bruce H. Kobayashi, Does Economics Provide a Reliable Guide to Regulating
Commodity Bundling by Firms? A Survey of the Economic Literature, 1 J. COMPETITION L. & ECON.
707, 707-08 (2005) (“Bundling is a ubiquitous phenomenon.”); Letter from Timothy J. Muris, Professor,
George Mason University School of Law, to Deborah A. Garza, Chair, Antitrust Modernization
Comm’n 3 (July 15, 2005) [hereinafter Muris], available at http://govinfo.library.unt.edu/amc/
commission_hearings/pdf/Muris.pdf (“Bundling is a ubiquitous, but not a uniform, practice.”). But cf.
Roy T. Engler, Jr., Defending the Result in LePage’s v. 3M: A Response to Other Commentators, 50
ANTITRUST BULL. 481, 493 (2005) (“Bundled rebates involving monopoly products are not ubiquitous
as far as I know.”) (emphasis added)).
131 LePage’s Inc. v. 3M Co., 324 F.3d 141 (3d Cir. 2003) (en banc).
132 See generally Kobayashi, supra note 130, at 707 (discussing the many types of bundling and
economic literature in the area).
some quantity (which can be expressed any number of ways) of another product that faces competition. The basic objection is that such discount structures can place single-product producers of the competitive product at a disadvantage. To retain customers in the face of the bundle, the single-product rival (in a simple model) must reduce the price of the competitive product in the aggregate by the amount of the discount on the monopoly product. 133 Put differently, the discount on the monopoly product translates into a “tax” on the single-product rival. 134

There is little dispute among courts and commentators that monopolists can impose this “tax” on single-product rivals; 135 significant controversy, however, surrounds its competitive significance. The LePage’s court, largely following the lead of antecedent SmithKline, 136 arguably held that a monopolist’s imposing of such a “tax” on rivals is presumptively exclusionary under Section 2 when it reduces the rival’s competitive constraint on the monopolist, a presumption that the defendant 3M failed to rebut with an efficiency justification. 137 LePage’s has generated significant controversy. For example, many assert that the LePage’s court did not clearly articulate what property made the bundled discounts unlawful. 138 Was the vice merely the adverse effect on the plaintiff? Something else? If something else, what else? According to this critique, LePage’s failed to articulate any coherent Section 2 legal test for bundled discounts. 139

More fundamentally, many critique LePage’s on the ground that its outcome harms rather than benefits competition by protecting inefficient competitors and by creating incentives for firms to pull their competitive punches. This point of view analogizes bundled discounts to predatory pricing. Observing that Brooke Group (and Barry Wright) created a safe harbor for above-cost pricing conduct in part on the asserted ground that such conduct cannot exclude equally efficient rivals, many argue that a cost-based

135 See generally AMC REPORT, supra note 52, at 96 (illustrating how a bundled discount can disadvantage a single-product rival), available at http://govinfo.library.unt.edu/amc/report_recommendation/chapter1.pdf.
136 SmithKline Corp., 575 F.2d at 1056.
137 See, e.g., Thomas A. Lambert, Evaluating Bundled Discounts, 89 MINN. L. REV. 1688, 1718-19 (2005) (so reading LePage’s). See Englert, supra note 130, at 492-96, for a defense of the result in LePage’s on this ground.
139 See Jacobson, supra note 52, at 23 (“LePage’s Inc. v. 3M . . . provides no guidance to business firms or their counselors as to which bundled pricing strategies are permissible and which are not.”); id. at 24 (“[LePage’s] articulated no actual ‘test’ for courts to apply.”).
approach should provide a protective screen for bundled discounts. All that is required, it is asserted, is to adapt *Brooke Group* to a multi-product context by allocating all discounts in the bundle to the competitive product and then determining whether that product is being sold above cost. If the competitive product is sold above cost under the resulting calculation, the argument runs, the bundle should be per se lawful. If not, further inquiry is required.

The Antitrust Modernization Commission ("AMC") recently recommended this approach to bundled discounts. The Commission proposed:

Courts should adopt a three-part test to determine whether bundled discounts or rebates violate Section 2 of the Sherman Act. To prove a violation of Section 2, a plaintiff should be required to show each one of the following elements (as well as other elements of a Section 2 claim): (1) after allocating all discounts and rebates attributable to the entire bundle of products to the competitive product, the defendant sold the competitive product below its incremental cost for the competitive product; (2) the defendant is likely to recoup these short-term losses; and (3) the bundled discount or rebate program has had or is likely to have an adverse effect on competition.\(^{140}\)

The first two requirements reflect a modified *Brooke Group* rule. The third requirement supplements *Brooke Group* with a Rule of Reason backstop. In other words, it is not enough for the plaintiff to demonstrate below-cost pricing with a reasonable prospect of recoupment; the plaintiff must also show an overall anticompetitive effect is likely (and/or rebut any asserted procompetitive justifications). The AMC's proposed test thus transforms *Brooke Group*'s two-part test for identifying predatory-pricing schemes that are likely to be anticompetitive into a mere screen that narrows the class of discounting practices subject to an underlying Rule of Reason balancing standard. Put differently, "[t]he AMC’s test, fundamentally, is the consumer welfare effects test with a safe harbor."\(^{141}\)

The justification for this cost-based safe harbor, according to its proponents, is that the benefits to antitrust enforcement of alternative legal tests are greatly outweighed by their costs. Echoing *Barry Wright*, it is argued that bundled discounts that can only exclude or impede less efficient single-product rivals are unlikely to result in significant long-term competitive harm. On the other side of the ledger, exposing all bundled discounts to a multi-factor Rule of Reason analysis threatens substantial false positives and is likely to deter many procompetitive pricing strategies. Undesirable spillover of the safe harbor into other areas of antitrust is assertedly avoided by making the cost-based test inapplicable when the monopolist declines to make the competitive product available on a stand-alone basis (and thus deprives the fact-finder of a benchmark against which to assess whether the competitive product is indeed sold below cost). Such cases, rather, should

\(^{140}\) AMC REPORT, *supra* note 52, at 99.

\(^{141}\) Jacobson, *supra* note 52, at 27.
be tested under exclusive dealing or tying principles where, it is asserted, no cost-based safe harbor properly applies. ¹⁴²

The AMC’s proposal, however, is not the only proposed legal test for bundled discounts. ¹⁴³ Some reject the predatory-pricing analogy for bundled discounts as inherently flawed, and instead argue that “bundled discounts raise anticompetitive concerns similar to those raised by exclusive dealing and tying arrangements.”¹⁴⁴ A cost-based test, these commentators further argue, suffers from numerous flaws. ¹⁴⁵ Among other criticisms, it is asserted that the attribution test improperly posits “disequilibrium behavior”—the monopolist could always make the bundle more restrictive, and at some point likely could make the “tax” great enough to exclude an equally efficient single-product rival.¹⁴⁶ Knowing this, the argument runs, such a rival will not seek to price-compete against the bundle. Moreover, these commentators posit, less efficient rivals protect consumers by constraining monopoly pricing. Accordingly, they argue, a deliberately underinclusive rule that gives strategies to exclude “less efficient” rivals a free pass is likely, on balance, to harm consumers, particularly because cost-based rules themselves are difficult to apply and are prone to error.¹⁴⁷ By contrast, some have criticized the attribution test as overinclusive because it potentially condemns numerous bundled discounts that are competitively benign.¹⁴⁸

In PeaceHealth,¹⁴⁹ the Ninth Circuit largely—but not completely—adopted the AMC’s proposed test. Examining the Ninth Circuit’s (incomplete) reasons for selecting between candidate Section 2 legal tests shows the importance of fully and completely undertaking the common-law inquiry that Section 2’s Rule of Reason requires.

PeaceHealth involved the markets for primary and secondary care on the one hand, and tertiary care on the other, in Lane County, Oregon.¹⁵⁰ Among other things, much larger PeaceHealth (which offered all types of care) gave insurers better deals if they purchased all three types of care from it than if insurers “purchased tertiary services from PeaceHealth, but

¹⁴² See id. at 26-27.
¹⁴³ See Lambert, supra note 137, at 1706-56, for a summary of various proposed approaches.
¹⁴⁴ E.g., EINER ELHAUGE & DAMIEN GERADIN, GLOBAL ANTITRUST LAW AND ECONOMICS 626 (Found. Press 2007).
¹⁴⁵ See, e.g., id. at 626-31.
¹⁴⁶ See id. at 630.
¹⁴⁷ See, e.g., id. at 628-30 (summarizing critiques of cost-based approach).
¹⁴⁸ See, e.g., Herbert J. Hovenkamp & Erik N. Hovenkamp, Exclusionary Bundled Discounts and the Antitrust Modernization Commission 10-20 (Univ. of Iowa Legal Studies Research Paper, No. 08-13, 2008), available at http://ssrn.com/abstract=1126723 (critiquing AMC’s attribution test on numerous grounds including its potential to condemn bundled discounts that take advantage of joint costs, implement secret price-cuts in oligopoly, or reflect welfare-increasing price-discrimination).
¹⁴⁹ Cascade Health Solutions v. PeaceHealth, 502 F.3d 895 (9th Cir. 2007), amended by, 515 F.3d 883 (9th Cir. 2008).
¹⁵⁰ 515 F.3d at 891.
at least some primary and secondary service from [PeaceHealth’s smaller, single-hospital rival] McKenzie.” Instructed based on a charge for bundled discounts derived from LePage’s that did not require below-cost pricing, a jury returned an attempted monopolization verdict for McKenzie, which was awarded treble damages and attorneys fees. In the first court of appeals decision since LePage’s to address bundled discounts in detail—having first taken the unusual step of calling for amicus submissions—the Ninth Circuit vacated the judgment.

The Ninth Circuit began its analysis in exactly the place as the framework advanced here: the court examined the competitive harms posed by bundled discounts in order to select the applicable baseline legal test. The court recognized that “the principal anticompetitive danger of the bundled discounts offered by PeaceHealth is that the discounts could freeze McKenzie out of the” market where they both operate because McKenzie “does not provide the same array of services as PeaceHealth.” In other words, the court acknowledged that PeaceHealth’s bundled discounts placed a “tax” on its smaller rival. Parting ways, it said, with LePage’s, the Ninth Circuit concluded that the “tax” posed a cognizable threat to “competition on the merits” only when it threatened to hinder an equally efficient rival. The court’s focus on protecting only equally-efficient rivals led it to adopt Brooke Group as the guiding “baseline” legal test. Predatory pricing law, in effect, condemns only price-cuts that could exclude equally efficient rivals; bundled discounts, the court reasoned, also describe conduct that on its face is good for consumers—lowering price—and thus presumptively should be subject to similar principles. As the court put it:

Of course, in neither Brooke Group nor Weyerhaeuser did the Court go so far as to hold that in every case in which a plaintiff challenges low prices as exclusionary conduct the plaintiff must prove that those prices were below cost. But the Court’s opinions strongly suggest that, in the normal case, above-cost pricing will not be considered exclusionary conduct for anti-

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151 Id. at 893.
152 Id.
153 Id. at 917-18.
154 Id. at 894-97.
155 Id. at 897.
156 PeaceHealth, 515 F.3d at 890, 909-10.
157 Several commentators nonetheless contend that bundled discounts in many circumstances are not reasonably necessary to achieve price cuts (but the practice can facilitate price discrimination). See, e.g., Englert, supra note 130, at 493-96 (“[T]here is absolutely no reason to think that bundled rebates move prices in the right direction.”); ELHAUGE & GERADIN, supra note 144, at 632-33; Jacobson, supra note 52, at 24. But employing this reasoning to effectively require defendants to justify many bundles, it is argued, “ignores the real-world effect of placing the burden of justification on the discounter.” Lambert, supra note 137, at 1724-25.
trust purposes, and the Court’s reasoning poses a strong caution against condemning bundled
discounts that result in prices above a relevant measure of costs.¹⁵⁸

Although adopting the Brooke Group baseline, the court recognized
that predatory pricing principles might not govern all bundled discounts. The AMC, for example, recommended subjecting bundled discounts to
different baseline tests depending on whether the competitive product is
made available on a stand-alone basis.¹⁵⁹ The Ninth Circuit reserved judg-
ment on this issue.¹⁶⁰ But by recognizing that different forms of bundled
discounts might warrant distinct legal treatment, the Ninth Circuit raised
more generally an issue that it declined to explore: whether different base-
lines for bundled discounts might be appropriate depending on the type of
competitive harm the discounts pose. For example, the court might have
asked whether bundled discounts that threaten harm to competition by rais-
ing rivals’ costs might be treated differently, and thus subjected to a differ-
ent legal test, than bundled discounts that threaten price predation.¹⁶¹ By
adopting the Brooke Group metaphor generally, the court can be faulted for
not undertaking a more rigorous examination of whether a different default
legal test might better minimize error and enforcement costs. The court
expressly recognized that “Brooke Group’s safe harbor for above-cost dis-
counting” is “not based on a theory that above-cost pricing strategies can
never be anticompetitive, but rather on a cost-benefit rejection of a more
nuanced rule.”¹⁶² Apart from its caveat for stand-alone availability, the
court appeared to assume, rather than determine through a more careful
analysis, that the cost-benefit analysis yields the same answer for all types
of bundled discounts.¹⁶³

¹⁵⁸ PeaceHealth, 515 F.3d at 901.
¹⁵⁹ See Jacobson, supra note 52, at 26-27.
¹⁶⁰ See PeaceHealth, 515 F.3d at 916 n.27.
¹⁶¹ See Englert, supra note 130, at 482-84, for an analysis that bundled discounts can anticompeti-
tively raise rivals’ costs by depriving the rival of scale economies. Many commentators recognize that
bundled discounts can harm competition in distinct ways. See, e.g., Muris, supra note 130, at 12-18
(distinguishing the use of bundled discounts to engage in price predation, “de facto” tying, and to ex-
clude rivals through increasing switching costs).
¹⁶² PeaceHealth, 515 F.3d at 904 (emphasis added).
¹⁶³ Cost-benefit analysis need not necessarily yield a fundamentally different test for different
circumstances. Cf. Muris, supra note 130, at 3 n.8 (arguing that the difficulty of proof under proposed
test for bundled discounts does not necessarily justify distinct legal treatment). However, it might justify
exceptions. For example, the court in Meijer, Inc. v. Abbott Labs. read Peace Health to permit crafting
an “exception” when mechanically applying the attribution test with an “average variable costs” bench-
mark would be a poor match with the theory of competitive harm. 544 F. Supp. 2d 995, 1002-05 (N.D.
Cal. 2008). Specifically, Meijer held that, even if the defendant meets the attribution test in the case of a
dual-purpose pill, the implied average variable cost of the competitive product might be so small that
applying the attribution test (if based on average variable costs) “would stifle competition” by deterring
entry by an equally efficient rival, because such a new entrant could not recover its massive fixed costs.
See id.
The next step in employing the Rule of Reason to select appropriate Section 2 legal tests is for courts to consider whether to depart from, or in some way modify, the baseline legal test. Here, the court answered both "no" and "yes." The Ninth Circuit's view that bundled discounts fundamentally involve price-cutting\textsuperscript{164} essentially predetermined the court's conclusion that it ought to apply a cost-based framework. Reitering the Supreme Court's concern that wrongly condemning price-cutting generates costly false positives, the court reasoned that "the course safer for consumers and our competitive economy" is to hold that "the exclusionary conduct element of a claim arising under § 2 of the Sherman Act cannot be satisfied by reference to bundled discounts unless the discounts result in prices below an appropriate measure of the defendant's costs."\textsuperscript{165} Notably, the court appeared to assume that LePage's supplied the only alternative to Brooke Group, and found that alternative wanting.\textsuperscript{166} The court did not, for example, inquire whether a different expression of the Rule of Reason—for example, a test under which a cost-based screen is only a presumptive rather than a completely preclusive safe harbor—might be appropriate, either generally or to any classes of bundled discounts. Nor did the court consider in any detail the costs to antitrust enforcement of its rule, under which the competitive constraint asserted by a less efficient rival counts for nothing.

Although adopting a cost-based safe harbor, the Ninth Circuit nonetheless recognized that differences between single-product price-cutting and bundled discounting required modifying the Brooke Group test.\textsuperscript{167} For one thing, the court modified the "below cost" prong.\textsuperscript{168} Here, the court did in fact engage in a more rigorous evaluation of candidate legal tests. The court rejected an "aggregate" approach, under which the package featuring a bundled discount is deemed sold below cost only if the package's price is below the sum of all of its component's relevant costs, because another "rule exists that is more likely to identify anticompetitive bundled discounting practices while at the same time resulting in little harm to competition."\textsuperscript{169} The court also rejected the so-called Ortho test because that test's focus on the efficiency of a particular plaintiff undesirably would increase enforcement costs.\textsuperscript{170} Instead, the court adopted an attribution test that turns

\textsuperscript{164} PeaceHealth, 515 F.3d at 903.
\textsuperscript{165} See id. at 900-03.
\textsuperscript{166} See id. at 906-09.
\textsuperscript{167} See id. at 903-04.
\textsuperscript{168} See id. at 903-07.
\textsuperscript{169} Id. at 905. The "aggregate" approach has been critiqued as a virtual rule of per se legality that wrongly assumes "(1) that above-cost bundled discounts are so unlikely to exclude equally or more efficient competitors that the search for exclusionary bundled discounts is not worth the effort, or (2) that there is no alternative evaluative approach that is easily administrable and is unlikely to overdeter procompetitive discounts." Lambert, supra note 137, at 1705. See Muris, supra note 130, at 21-27, for a defense of the "aggregate" approach.
\textsuperscript{170} PeaceHealth, 515 F.3d at 905.
solely on the defendant's cost structure under which, assertedly, "bundled discounts [are] legal unless the discounts have the potential to exclude a hypothetical equally efficient producer of the competitive product." This test, the court reasoned, "provides clear guidance for sellers that engage in bundled discounting" because "[a] seller can easily ascertain its own prices and costs of production and calculate whether its discounting practices" violate the rule. The court adopted average variable costs as the appropriate measure of costs based on the same minimize-enforcement-costs reasoning.

Whether the Ninth Circuit selected the correct legal test to govern the type of bundled discount before it, the court's assertion that the adopted attribution test supplies "clear" guidance is overstated. In the test's application, courts may need to make further tradeoffs between providing clear notice and ensuring that the rule selected "identifies anticompetitive bundled discounting practices while at the same time [causing] little harm to competition." For example, suppose the rival producer of the competitive product cannot contest all of the monopolist's sales of that product, but only a portion (and that the monopolist knows this). Should the attribution analysis assume, and be performed on the basis, that all sales of competitive product are contestable, or (as is reality) only that portion?

This question may seem down into the weeds, but the answer can greatly affect whether the attribution test, in at least this circumstance, serves its asserted purpose of protecting hypothetically equally efficient rivals from exclusionary bundles. The larger the base of sales over which the attribution test is conducted, the smaller the contribution of the monopoly product's discount to the cost of the competitive product, and the more likely that the competitive product in a package will be found to be sold above cost. A bright-line rule that assumes that a plaintiff can switch all sales is easier to apply (both by potential defendants and the courts); but it may fail to capture an important circumstance where, in the real world, a more efficient competitor can be excluded because that rival can only realistically switch a portion of the defendant's sales.

171 Id. at 906.
172 Id. at 907.
173 See id. at 909-10. See supra note 163, for a discussion of the subsequent Meijer court's criticism of, and departure from, the average variable costs approach.
174 PeaceHealth, 515 F.3d at 905.
175 For example, suppose monopolist A sells X, which has market power, for $100 on a stand-alone basis and Y for $1. Y has a cost of $.79/unit and X is sold well in excess of cost. There is a single customer who demands 1 unit of X and 100 units of Y. Suppose Firm B seeks to enter into the business of selling in competition of Y; Firm B's Y has lower per unit costs than Firm A's (suppose $.75/unit), but B is capacity constrained, and can offer only 50 units. Further suppose that Firm A reacts to B's entry by creating a bundled option for the customer: if the customer purchases its requirements of Y from A (at $1/unit), then the price of X drops to $80; if not, X's price remains $100. If the attribution test is conducted on the basis of all sales of Y, Firm A's bundle will pass the attribution test. The incremental
Of course, entertaining evidence and expert testimony on the proper percentage of sales over which to conduct the attribution test would add to litigation (and potential error) costs without directly answering the ultimate question of whether the bundled discount at issue is likely to cause market-wide prices to rise or fall relative to a world without the practice. Courts applying or considering whether to adopt PeaceHealth must consider these possible additional sources of error and enforcement costs.

PeaceHealth also altered other aspects of the baseline Brooke Group test and declined to adopt modifications recommended by others. For example, the court declined to adopt the AMC-recommended recoupment requirement. The court explained that such a requirement might create false negatives in some cases by exonerating anticompetitive bundling strategies that require incurring no short-term loss. The court here, again, failed to consider whether the specific example it cited can be generalized to bundled discounts as a class such that the error and enforcement costs of a recoupment requirement exceed its benefits. Now, it may well be that the reduction of false positives from applying a recoupment screen to a sub-group of bundled discounts is not worth the costs to antitrust enforcement that stem from identifying when that secondary safe harbor ought to apply. Such a screen requires distinguishing between bundled discounts where recoupment is simultaneous and those where it is not, a step that may increase litigation costs for little gain. But the Ninth Circuit provided no convincing ground for its conclusion that a recoupment requirement is not "analytically helpful."

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revenue from Y is $100, which is greater than Y’s incremental cost, including all discounts on X, which is $99 ($7.99 x 100) + $20). This bundle can also exclude B, even if B reduces price down to its lower costs: the customer’s total cost of X and Y if it deals only with A is $180 ($80 + $100). By contrast, if the customer purchases 50 units of Y from Firm B (and, as it must, purchases the remainder from Firm A), the customer’s total costs are $187.50 ($100 for X; $50 for 50 units of Y from Firm A; and $37.50 (50 x $.75) for 50 units of Y from Firm B). Accordingly, the bundle will induce the customer to deal only with Firm A, and under an attribution test conducted over all units, Firm A can exclude Firm B, even though Firm B is more efficient. By contrast, if the attribution test is conducted based on the number of contestable units (recognizing that 50 units of A are not in play, so the $20 discount on X should be spread over 50 units, not 100), Firm A’s bundling strategy will fail the attribution test. Incremental revenue from contestable units is $50 ($1 x 50), which is less than incremental cost $59.50 ($7.99 x 50) + $20).

176 The court also declined to adopt the AMC's proposed third prong of anticompetitive effects. The court believed that requirement redundant to a successful showing of antitrust injury. See PeaceHealth, 515 F.3d at 910 n.21. The court not only misunderstood that antitrust injury is not the same as anticompetitive effects, but also ignored the possibility of government suits, where the antitrust injury doctrine is inapplicable.

177 See id.

178 Id. Some have advocated for a modified recoupment requirement or bundled discounts reoriented to inquire into potential anticompetitive effects. See Hovenkamp & Hovenkamp, supra note 148, at 20-27.
*PeaceHealth*, in other words, arguably proceeded too quickly both in seemingly adopting a cost-based safe harbor applicable to all bundled discounts and in universally eliminating a recoupment requirement. The Rule of Reason requires courts to do the hard work of examining the range of conduct potentially subject to the proposed legal test considered and asking whether the conduct as a class really should be subject to a single doctrine, grappling with alternative legal frameworks and their associated error and enforcement costs, and then selecting, through a careful analysis given the information available, the best test for the circumstances.

**CONCLUSION**

*Microsoft* and *Trinko* have ushered in an era in which the application of Section 2 in many circumstances is unsettled. Courts today confront the practical challenge of elaborating Section 2’s Rule of Reason in light of precedent and sound analysis. In developing Section 2 legal tests, courts must consider the relative merits of candidate legal tests and the error and enforcement costs associated with applying those tests relative to alternatives, recognizing the real-world circumstances in which those tests are applied or enforced. That setting includes, among other factors: (1) which doctrines govern closely related conduct; (2) the ease with which courts can distinguish the conduct at issue from other such conduct; (3) the confidence with which courts can predict the likely competitive consequences of the conduct; (4) the relative benefits of adopting a rule as opposed to a standard; and (5) the practical difficulties that economic actors and courts will confront in applying the selected test.

Safe harbors for unilateral conduct are no different. Establishing a safe harbor requires a Section 2 court to predict with confidence that the conduct in question is really different (in its features and economic consequences) from other conduct such that the conduct properly is governed by some different legal test. The court must predict that the selected legal test sufficiently minimizes error and enforcement costs relative to applying other legal tests. In conducting this inquiry, the court is not restricted to a binary choice between a seemingly simple safe harbor and open-ended Rule of Reason balancing, but rather must also consider other potential legal tests that might better minimize error and enforcement costs and thus over the long-run potentially better serve competition and consumers.

Courts, in other words, must ask if the unilateral conduct in question *really* is different from other conduct, *how* it is different, and *whether* those differences justify distinct legal treatment. *Copperweld* may instruct that the distinction between unilateral and concerted action is “basic;” but the full content of that distinction remains unsettled. Demarcating the boundaries of that distinction by crafting Section 2 legal tests that well serve the interests of competition and consumers is one of the chief tasks that antitrust courts will confront in the years ahead.