

# Section 2 and the Rule of Reason: Report from the Front



---

By Mark S. Popofsky & Ariel A. Martinez<sup>1</sup>

Courts remain, in the words of one observer, mired in an “exclusionary conduct ‘definition’ war.”<sup>2</sup> Applying Section 2’s broad prohibition on “monopolizing” conduct requires courts to select a governing legal test. Section 2 legal tests run the spectrum from rules of *per se* legality to rules of near *per se* illegality.<sup>3</sup> Courts, nonetheless, largely apply two dominant paradigms. The first consists of legal tests based on bright-line rules or safe harbors. Familiar examples include the *Brooke Group*<sup>4</sup> below-cost price test for analyzing predatory pricing claims and the *Aspen/Trinko*<sup>5</sup> “profit sacrifice” test for refusals to deal. Developing bright-line rules for Section 2, proponents argue, promotes business certainty and reduces the risk of chilling otherwise procompetitive conduct. The second paradigm is rule of reason balancing. Arguably the default Section 2 legal test,<sup>6</sup> courts and commentators have described Section 2’s rule of reason in various ways: as mandating a step-wise approach, as requiring a balancing of pro- and anticompetitive effects, or (to borrow from Section 1) a framework for generating the enquiry “meet for the case.”<sup>7</sup> However the rule of reason is expressed, its champions contend, its flexibility and fact-intensive approach permits courts to identify anticompetitive conduct without the under-inclusion that is an admitted feature of safe harbors and other bright-line rules.

Recent Section 2 decisions reflect this debate and carry forward longstanding patterns in Section 2 case law. First, courts analyzing claims of predatory pricing or refusals to deal have declined invitations to cut back on the bright-line rules created by *Brooke Group* and the dominant interpretation of *Aspen/Trinko*. Plaintiffs’ creative efforts to erode these protective doctrines have largely failed. Second, courts reviewing challenges to

---

<sup>1</sup> Ropes & Gray LLP, Washington, D.C.

<sup>2</sup> Andrew I. Gavil, *Exclusionary Distribution Strategies By Firms: Striking a Better Balance*, 72 ANTITRUST L.J. 3, 5 (2005).

<sup>3</sup> See generally Mark S. Popofsky, *Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules*, 73 ANTITRUST L.J. 438 (2006).

<sup>4</sup> *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

<sup>5</sup> *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985); *Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

<sup>6</sup> See generally Popofsky, *supra* note 3.

<sup>7</sup> *Cal. Dental Ass’n v. FTC*, 526 U.S. 756, 781 (1999).





exclusive dealing, bundled discounts, and loyalty discounts have confronted an initial choice whether to characterize the asserted mechanism of exclusion as involving price (requiring analysis under *Brooke Group*) or non-price (requiring analysis under the rule of reason, including use of market power, foreclosure, and other screens). Third, courts assessing allegations involving product design have nominally applied a rule of reason framework, but, in practice, look for indicia that the conduct is coercive and lacks a legitimate business justification.

## I. PREDATORY PRICING & REFUSALS TO DEAL

Plaintiffs challenging prices as predatory or refusals to deal as unlawful confront the steep hurdles that *Brooke Group* and the *Aspen/Trinko* line of cases erected. Courts are unlikely to sustain claims without well-founded allegations that the defendant priced below cost with a dangerous probability of recoupment (in the case of predatory pricing), or without a profit sacrifice and termination of a prior course of dealings (in the case of a refusal to deal). Not surprisingly, recent litigations asserting such claims feature creative efforts to circumvent these seemingly bright-line Section 2 rules. These attempts have produced mixed results.

Courts have declined invitations to expand duties to deal absent (i) a preexisting voluntary course of dealing and (ii) conduct evincing a profit sacrifice — the rule many courts draw from the Supreme Court’s decisions in *Aspen* and *Trinko*. The Tenth Circuit, in *Novell, Inc. v. Microsoft Corp.*,<sup>8</sup> provides a recent example. There, the court rejected a claim that Microsoft unlawfully refused to deal with an independent software vendor when Microsoft stopped providing vendors with access to certain application programming interfaces. The court held that Microsoft’s conduct evinced a desire to promote (rather than sacrifice) short-term profits and, therefore, Novell could not fit its case within the narrow *Aspen/Trinko* exception to the principle that a firm may generally choose its business partners freely. Although Novell tried to characterize Microsoft’s conduct as not the negative act of refusing to deal, but rather the “‘affirmative’ act of interference” through withdrawing preexisting support, the Tenth Circuit ruled that “[t]raditional refusal to deal doctrine is not so easily evaded.”<sup>9</sup> The Tenth Circuit acknowledged that the *Aspen/Trinko* rule may be underinclusive — it might exonerate some refusals to deal that harm consumers. Nonetheless, the court reasoned: “If the doctrine fails to capture every nuance, if it must err still to some slight degree, perhaps it is better that it should err on the side of firm independence” than “on the other side where we face the risk of inducing collusion and inviting judicial central planning.”<sup>10</sup>

*Steward Health Care Systems, LLC v. Blue Cross & Blue Shield of Rhode Island*,<sup>11</sup> by contrast, presents a rare instance in which application of the *Aspen/Trinko* test produced a plaintiff-friendly outcome. The case arose from Steward’s failed attempt to acquire Landmark Medical Center in Woonsocket, Rhode Island. Steward, which sells health plans and runs community hospitals, abandoned the acquisition, according to its complaint, because Blue Cross refused to accept attractive rates that Steward offered Blue Cross for reimbursement of Blue Cross subscribers treated at Landmark. In particular, Steward averred that Blue Cross rejected proposed reimbursement rates 5 percent **below** the average rates Blue Cross accepted from other Rhode Island providers. Blue Cross’s discriminatory refusal to deal, Steward alleged, formed only part of an anticompetitive scheme to maintain an asserted monopoly in the Rhode Island commercial hospital services market. Blue Cross sent letters to doctors that used Landmark, informing them of Landmark’s imminent

---

<sup>8</sup> 731 F.3d 1064 (10th Cir. 2013).

<sup>9</sup> *Id.* at 1078-79.

<sup>10</sup> *Id.* at 1076.

<sup>11</sup> 997 F. Supp. 2d 142 (D.R.I. 2014).





removal from Blue Cross's network, refused to renew its contracts with St. Anne's hospital (a nearby Steward-owned facility), and engaged in an intense lobbying effort to defeat a bill that would have enabled Steward to implement its community hospital care model in Rhode Island.

Blue Cross argued that Steward failed to state a valid refusal to deal claim, because Steward's complaint alleged that it sought to increase reimbursement rates at Landmark. On a motion to dismiss, the court refused to find that concession dispositive. The court held instead that the complaint contained sufficient allegations that Blue Cross terminated a profitable prior course of dealings, stressing Blue Cross's failure to accept terms it accepted from others. That Steward sought to impose a duty on Blue Cross to buy rather than sell, the court ruled, amounted to a distinction without difference. As in other refusal to deal cases where plaintiffs achieved a positive outcome, discrimination against a customer based on its identity as a competitor is the key to explaining the result in *Steward*. *Otter Tail*,<sup>12</sup> for example, is often viewed through that lens.

Just as recent Section 2 decisions have adhered to the *Aspen/Trinko* doctrine, courts have rejected attempts to water down *Brooke Group*. In *Superior Production Partnership v. Gordon Auto Body Parts Co., Ltd.*,<sup>13</sup> the Sixth Circuit granted defendant summary judgment in a case seeking to challenge low pricing in the market for replacement bumpers. Although plaintiff's expert opined that defendant's prices had a "disturbing" proximity to cost, plaintiff could not adduce triable evidence that prices fell below average total cost or average variable cost. The plaintiff instead argued that its rival's conduct amounted to predation under a "no economic sense" test, because the defendant's conduct was not profit maximizing. The Sixth Circuit rejected this attempt to circumvent *Brooke Group*. Echoing then-Judge Breyer's analysis in *Barry Wright*, the court stressed the value of a bright-line rule to foster conduct the Sherman Act is designed to encourage (price cutting), explaining "without a cost-based test of predation, courts would inevitably punish firms for being the most efficient producers."<sup>14</sup>

## II. EXCLUSIVE DEALING & BUNDLED / LOYALTY DISCOUNTS

The choice between applicable Section 2 legal tests remains critically important in cases involving exclusive dealing and related practices, such as bundled discounts and loyalty discounts. The outcome in these cases frequently turns on how the court characterizes the conduct. If the court views the conduct as involving price — typically the case with bundled discounts — *Brooke Group*'s below-cost framework (modified in the case of bundled discounts to include an attribution test) often governs. By contrast, if the mechanism of securing exclusivity is not merely low prices, courts typically apply the rule of reason. The rule of reason analysis, depending on context, may include a screen that exonerates the conduct in question unless it forecloses a substantial share of the relevant market.

Recent Section 2 cases fit this pattern. The Eleventh Circuit recently applied a rule of reason framework to uphold the FTC's invalidation of an exclusive dealing arrangement in *McWane v. FTC*.<sup>15</sup> There, McWane, an asserted domestic pipe fittings monopolist, implemented a "Full Support Program." Under the program, McWane cut off sales to distributors who purchased from McWane's competitors. According to the court, the FTC's evidence showed both that McWane initiated the Full Support Program to raise a competitor's costs and protect monopoly power and that McWane substantially achieved its objective. Despite entry (through outsourcing arrangements rather than establishment of a domestic foundry), the Full Support

---

<sup>12</sup> *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973).

<sup>13</sup> 784 F.3d 311 (6th Cir. 2015).

<sup>14</sup> *Id.* at 326.

<sup>15</sup> 783 F.3d 814 (11th Cir. 2015).





Program was designed to foreclose and direct pricing evidence showed it was successful, because “McWane’s prices and profit margins for domestic fittings were notably higher than prices for imported fittings, which faced greater competition.”<sup>16</sup>

Against this backdrop, the court upheld the FTC’s condemnation of McWane’s conduct under the rule of reason framework articulated in *United States v. Microsoft*.<sup>17</sup> Because the conduct involved exclusive dealing, the court invoked a substantial foreclosure screen, reasoning that “foreclosure … ‘serves a useful screening function’ as a proxy for anticompetitive harm.”<sup>18</sup> The court found the screen easily met, because evidence showed that the Full Support Program tied up the two largest distributors, who accounted for 50-60 percent of the relevant market. A significant foreclosure percentage, when added to evidence of cost-raising intent, higher prices, and pretextual justifications, amply supported a finding of monopoly maintenance.

*McWane* involved conduct much like the seminal *Lorain Journal*<sup>19</sup> case — cutting off customers who patronize rivals. Courts do not hesitate to analyze such conduct under principles applicable to exclusive dealing cases. Indeed, according to *McWane*, such conduct “arguably pose[s] a greater threat to competition than a conventional exclusive dealing contract, as it lack[s] the traditional procompetitive benefits of such contracts.”<sup>20</sup> When firms use price to induce exclusivity, however, courts frequently reach a different outcome by analyzing the conduct under *Brooke Group*.

In *Eisai, Inc. v. Sanofi-Aventis U.S., LLC*,<sup>21</sup> for example, competitor Eisai challenged Sanofi’s discounting structure for Lovenox, the alleged leading product in its therapeutic class. The greater the volume of Lovenox the customer took and the greater the share Lovenox comprised of a customer’s purchases within its class, the greater the discount the customer received. Sanofi moved for summary judgment, arguing that Eisai failed to demonstrate that Sanofi’s discount structure amounted to the below-cost pricing that *Brooke Group* condemned. Eisai, by contrast, argued that the court should not analyze the conduct under *Brooke Group*, because the conduct did not predominantly involve price. According to Eisai, among other things, Sanofi “imposed disloyalty penalties that were not the same as discounts,” “bundled contestable and incontestable demand for Lovenox,” and engaged in sharp marketing tactics.<sup>22</sup>

The court declined to find these (or other) attributes of Sanofi’s conduct sufficient to remove *Brooke Group*’s price-cost test and apply an open-ended rule of reason analysis. Notably, the court found “further support for its conclusion that this is a pricing case from the fact that Eisai could have increased its discounts” to increase its sales.<sup>23</sup> In other words, Eisai’s failure to compete harder doomed its case. The court further held that it would reach the same conclusion even were the conduct characterized as non-price exclusive dealing and analyzed under the rule of reason. Competitors’ success, according to the court, showed that Sanofi’s Lovenox program did not foreclose competition in a substantial share of the relevant market.<sup>24</sup>

---

<sup>16</sup> *Id.* at 838-39.

<sup>17</sup> 253 F.3d 34 (D.C. Cir. 2001).

<sup>18</sup> *McWane*, 783 F.3d at 835 (quoting *Microsoft*, 253 F.3d at 69).

<sup>19</sup> *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951).

<sup>20</sup> *McWane*, 783 F.3d at 834.

<sup>21</sup> No. 08-cv-4168, 2014 WL 1343254 (D.N.J. Mar. 28, 2014).

<sup>22</sup> *Id.* at \*26.

<sup>23</sup> *Id.* at \*27.

<sup>24</sup> *Id.* at \*30.





In contrast, the Third Circuit in *ZF Meritor, LLC v. Eaton Corp.*<sup>25</sup> applied the rule of reason — rather than a price-based test — to invalidate defendant's long-term agreements with direct purchasers that, in relevant part, offered lower prices via rebates and conditioned supply on the purchase of a specified percentage of the customer's requirements. As a threshold matter, the court held that the price discounts at issue were not the driving force behind customers' compliance with purchase targets; rather, Eaton enforced compliance by threatening to cut customers off from access to products critical to their business if they failed to meet purchase targets. Refusing to find price the predominant mechanism of exclusion, the court declined to apply *Brooke Group*. Applying a rule of reason framework, the court upheld the jury's verdict finding defendant's conduct unlawful. Evidence showed, among other things, that defendant's program effectively required every direct purchaser in the market to obtain 80-97.5 percent of their requirements from the defendant, severely constricting sales for which rivals could compete. The jury, moreover, permissibly found that the contracts were not short-term — often an exonerating factor under rule of reason analysis of *de facto* exclusive dealing — but rather long-term. Additionally, and in the court's view critically, "there was considerable evidence from which a jury could infer that the primary purpose" of Eaton's contracts "was not to meet customer demand, but to take preemptive steps to block potential competition."<sup>26</sup>

Recent decisions assessing the legality of bundled discounts applied a modified version of *Brooke Group*, consistent with the Ninth Circuit's leading decision in *PeaceHealth*.<sup>27</sup> In *Vesta Corp. v. Amdocs Management Ltd.*,<sup>28</sup> for example, plaintiff alleged that defendants, through a package that bundled together a billing platform and a payment processing solution, illegally excluded plaintiff from the payment processing market. The court ruled that, to show the conduct was anticompetitive, the plaintiff needed to allege the price of payment processing services was below cost "after allocating the discount given by the defendant on the entire bundle" to that product.<sup>29</sup> Plaintiff's complaint failed to meet this attribution test because it contained only speculative allegations as to defendants' costs. The court stressed the importance of fidelity to the attribution test because "[courts] should not be too quick to condemn price-reducing bundled discounts as anticompetitive, lest we end up with a rule that discourages legitimate price competition."<sup>30</sup>

### III. PRODUCT DESIGN

Product design remains another unsettled area of Section 2. Some cases have suggested that product designs producing consumer benefits are *per se* legal, at least absent a coercive withdrawal of a prior formulation.<sup>31</sup> *United States v. Microsoft*, although nominally applying a balancing test, appeared to condemn the design conduct at issue there, because it lacked any justification.<sup>32</sup> Other decisions similarly reflect a

---

<sup>25</sup> 696 F.3d 254 (3d Cir. 2012).

<sup>26</sup> *Id.* at 288.

<sup>27</sup> *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008).

<sup>28</sup> No. 3:14-cv-1142-HZ, 2015 WL 5178073 (D. Or. Sep. 3, 2015).

<sup>29</sup> *Id.* at \*18 (quoting *PeaceHealth*, 515 F.3d at 910).

<sup>30</sup> *Id.* (quoting *PeaceHealth*, 515 F.3d at 896).

<sup>31</sup> *Allied Orthopedic v. Tyco*, 592 F.3d 991, 998-99 (9th Cir. 2010); *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 287 (2d Cir. 1979).

<sup>32</sup> See *Microsoft*, 253 F.3d at 58-60.





binary approach to product design: if the conduct lacks any benefit and is coercive, it is invalidated; if the conduct produces benefits, challenges to the conduct fail.<sup>33</sup>

Two recent cases add to this debate. The courts in *New York ex rel. Schneiderman v. Actavis PLC* and *Mylan Pharmaceuticals, Inc. v. Warner Chilcott Public Ltd., Co.* each confronted allegations of product redesign, but reached different results. In *Actavis*, the Second Circuit upheld a preliminary injunction against Actavis, finding that Actavis's "hard switch" — from an immediate release to an extended release Alzheimer's drug (the only two drugs in the relevant market) — coerced patients to switch to the new drug and impeded generic competition.<sup>34</sup> Toward the end of the patent period, Actavis developed an extended release drug and effectively withdrew its immediate release version. The State of New York argued that Actavis's conduct comprised an anticompetitive "product hop" because generics would not be therapeutically equivalent as required for automatic substitution under state law. Actavis, New York contended, thereby unlawfully maintained monopoly power. The Second Circuit agreed, holding that product innovation — though generally beneficial to consumers — can be anticompetitive when a firm coerces consumers to switch to a new product rather than permitting a new product to compete on the merits, particularly where the prior product was successful and there was no legitimate business justification for withdrawal. Applying *Microsoft*'s burden shifting rule of reason framework, the court rejected Actavis's claimed procompetitive benefits as pretextual in light of ample evidence that Actavis sought to prevent generic substitution to protect revenues after its patent expired.

The Eastern District of Pennsylvania reached a different result in *Mylan*, where the court granted defendants' motion for summary judgment.<sup>35</sup> According to the complaint, defendants redesigned their branded antibiotic, Doryx, to exclude generic competitors. The alleged "product hopping" included, converting capsules to tablet form, introducing scores on tablets to facilitate different dosing, and withdrawing older versions. As in *Actavis*, these changes prevented automatic substitution of generics. In contrast to *Actavis*, however, the court held that plaintiff failed to demonstrate triable evidence of anticompetitive conduct. For one thing, the court found insufficient evidence of monopoly power. For another, the court found that Mylan had numerous other ways of promoting its generic Doryx products other than automatic substitution. Redesigning products without more, even where the redesign prevents automatic substitution, is not, the court held, presumptively anticompetitive. To adopt such a rule would, in the court's view, "risk[] slowing or even stopping pharmaceutical innovation."<sup>36</sup> The court also cast doubt on balancing under the rule of reason even if Mylan had established a *prima facie* case of anticompetitive conduct: "Once the branded drug manufacturer offered a procompetitive justification for the product change that the generic manufacturer could not rebut, courts and juries would have to determine which product changes were 'sufficiently innovative' to justify their anticompetitive effects."<sup>37</sup> The judge "doubt[ed] that courts could ever fashion" an administrable method of calculating this tradeoff.<sup>38</sup>

---

<sup>33</sup> Compare *C.R. Bard, Inc. v. M3 Sys., Inc.*, 157 F.3d 1340, 1371-72 (Fed. Cir. 1998) (upholding jury verdict invalidating product redesign lacking any consumer benefit) with Final Jury Instructions Re Genuine Product Improvement at 19, *Apple iPod iTunes Antitrust Litig.*, No. 05-cv-0037 (N.D. Cal. Dec. 15, 2014) (instructing jury that genuine product improvement cannot be considered an anticompetitive act regardless of its effect on competitors).

<sup>34</sup> 787 F.3d 638, 652-53 (2d Cir. 2015).

<sup>35</sup> No. 12-3824, 2015 WL 1736957, at \*12-13 (E.D. Pa. Apr. 16, 2015).

<sup>36</sup> *Id.* at \*16.

<sup>37</sup> *Id.* at \*15 (quoting *Microsoft*, 253 F.3d at 58-59).

<sup>38</sup> *Id.*





The contrasting results in *Actavis* and *Mylan* can be viewed through the lens of presumptions courts apply in the course of conducting a Section 2 rule of reason analysis. The *Actavis* court arguably presumed conduct that had an impact on rivalry lacked a legitimate justification when the only proffered reason for the product hop was to increase another product's sales. *Mylan* seemingly employed a different presumption: if a generic's only source of harm is an inability to take advantage of automatic substitution laws, the conduct is presumed lawful, at least absent evidence of an inability to market to customers through other means.

#### IV. CONCLUSION

Courts continue to grapple with the question of which Section 2 legal test to apply to alleged anticompetitive conduct. Recent Section 2 decisions fit longstanding patterns. Where the conduct involves straightforward, single-product pricing or a refusal to deal, courts adhere to the bright-line tests set forth in *Brooke Group* and *Aspen/Trinko*. In other instances, the characterization of conduct — as involving predominantly price versus non-price mechanisms or as innovative versus inherently exclusionary — remains a key determinant in identifying the appropriate legal test. Finding the “enquiry meet for the case”<sup>39</sup> will, no doubt, remain a challenge for antitrust courts for years to come.

---

<sup>39</sup> *Cal. Dental Ass'n*, 526 U.S. at 781.

