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THE CONSUMER HARM INQUIRY IN RECENT CASES: A REQUIRED ELEMENT OF PROOF OR AN AFTERTHOUGHT?

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I. INTRODUCTION

The purpose of the antitrust laws is to protect competition and consumer welfare. Both courts and the enforcement agencies seemingly agree that consumer harm, in the form of actual or threatened market-wide, material and sustained reduction in output (in either quantity or quality) or an increase in price, is a required element in proving an antitrust violation in cases arising under both Sections 1 and 2 of the Sherman Act (other than those involving *per se* violations or the "quick look" doctrine). Indeed, the Supreme Court has made clear that actual harm to consumers must be proven. However, lower courts have not always followed the Supreme Court's instructions. In two cases decided in 2003, the Second Circuit's decision in *United States v. Visa U.S.A.* and the Third Circuit's decision in *LePage's v. 3M*, the courts have not required proof of actual consumer harm.

II. THE SUPREME COURT REQUIRES PROOF OF CONSUMER HARM IN CASES ARISING UNDER SECTIONS 1 AND 2 OF THE SHERMAN ACT

Ever since its proclamation in *Brown Shoe* that the antitrust laws protect "competition, not competitors,"[1] the Supreme Court has taken every opportunity to emphasize that the antitrust laws exist for the benefit of consumers.[2] Accordingly, it has stated that proof of consumer harm is a necessary element in cases brought under both Sections 1 and 2 of the Sherman Act.

Under Section 1, the Court, in *California Dental Ass'n v. Federal Trade Comm'n*,[3] insisted on actual empirical evidence of consumer harm. A non-profit professional association of dentists sought judicial review of a Federal Trade Commission ("FTC") cease and desist order directed at advertising restrictions that had been imposed by the California Dental Association ("CDA"). Those restrictions related to discount advertising and advertising related to the quality of dental services. The CDA claimed the restrictions were

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1 *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

2 *See, e.g., Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993) ("The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market"); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) ("Congress designed the Sherman Act as a 'consumer welfare prescription'").

3 526 U.S. 756 (1999).

intended to assist members in complying with its code of ethics and with state law. In a proceeding initiated by the FTC, an administrative law judge found that restrictions on discount and quality advertising amounted to an unlawful restraint on trade. The FTC introduced no empirical evidence and no expert economist testified that consumers had been harmed by the advertising restrictions. The Ninth Circuit Court of Appeals affirmed the administrative law judge's decision and characterized the advertising restrictions as "naked restrictions on price."[4]

The Supreme Court rejected that characterization, insisting that empirical evidence of actual consumer harm was required:

> [The Ninth Circuit's] observations brush over the professional context and describe no anticompetitive effects. Assuming that the record in fact supports the conclusion that the CDA disclosure rules essentially bar advertisement of across-the-board discounts, it does not obviously follow that such a ban would have a net anticompetitive effect here. Whether advertisements that announced discounts for, say, first-time customers, would be less effective at conveying information relevant to competition if they listed the original and discounted price for checkups, X-rays, and fillings, than they would if they simply specified a percentage discount across the board, seems to us a question susceptible to empirical but not *a priori* analysis.[5]

The Court further elaborated on its criticism of the lower court and the Ninth Circuit Court of Appeals for having missed the ultimate issue of consumer harm:

> [T]he relevant output for antitrust purposes here is presumably not information or advertising, but dental services themselves. The question is not whether the universe of possible advertisements has been limited (as assuredly it has), but whether the limitation on advertisements tends to limit the total delivery of dental services.[6]

Here, the Supreme Court refused to draw an inference of anticompetitive harm without actual evidence of higher prices or reduced supply to consumers, the hallmarks of consumer injury.

The notion of consumer harm has been an integral part of the Supreme Court's treatment of claims arising under Section 2 of the Sherman Act. In predatory pricing cases, for example, the Court has observed that the requirement that a plaintiff prove recoupment ensures that conduct that benefits consumers is not condemned under the antitrust laws: "although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers."[7]

In cases arising under Section 2 based on exclusionary practices, the Supreme Court has required a nexus between the exclusionary practice and the welfare of consumers. Indeed, it has required proof as to how consumers have been harmed by the challenged

4 128 F.3d 720, 727 (9th Cir. 1997).
5 526 U.S. at 774.
6 *Id.* at 776.
7 *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993).

practice. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, an exclusionary practices case, is instructive.[8] That case involved a dispute among downhill skiing facilities in Aspen, Colorado. Plaintiff Aspen Highlands owned one facility, while defendant Aspen Skiing Co. owned the other three in the area. The parties had entered into a joint marketing arrangement whereby they offered an "All Aspen" ticket that permitted ticket holders to ski at all four facilities. When Skiing Co. discontinued its participation in the joint marketing program, Aspen Highlands brought a Section 2 claim, alleging that Skiing Co. had monopolized the market for downhill skiing in the area and had made it extremely difficult for Aspen Highlands to compete.

The Supreme Court upheld the lower court's decision that Aspen Skiing's conduct had violated Section 2. In addition to finding that Aspen Skiing had not offered an efficiency justification for discontinuing its participation in the joint marketing program, the Court also held that Aspen Skiing's conduct harmed consumers.[9] Aspen Highlands had introduced ample evidence at trial that consumers preferred the "All Aspen" ticket, including that of an expert marketing witness and anecdotal evidence from a number of witnesses, including a tour operator, an officer of a Ski Club and the marketing director of Aspen Highlands' ski school.[10] The Court concluded:

> Thus the evidence supports an inference that Ski Co. was not motivated by efficiency concerns and that it was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival.[11]

The nexus between the injury to Aspen Highlands and the corresponding harm to consumers as a result of Aspen Skiing's conduct seems to form the basis for the finding of liability.

Two decisions by circuit courts of appeals in 2003, one brought under Section 1 of the Sherman Act and the other brought under Section 2, have failed to follow the Supreme Court's mandate regarding proof of consumer harm. In *United States v. Visa U.S.A., Inc.*, the Second Circuit Court of Appeals affirmed the decision of the trial court that the two payment card networks' loyalty rules restrained trade in violation of Section 1.[12] Neither the lower court nor the Second Circuit Court of Appeals insisted on any actual evidence of consumer harm. In *LePage's Inc. v. 3M*, the Third Circuit Court of Appeals, *en banc*, affirmed the jury's verdict that exclusionary conduct, including bundled rebates and exclusive dealing, violated Section 2.[13] There was no consideration of consumer harm in *LePage's*. Rather, consumer harm appears to have been presumed based on the defendant's exclusionary conduct. These decisions are discussed in detail below.

III. *UNITED STATES V. VISA U.S.A., INC.*

Both Visa and MasterCard are organized as open joint ventures that are owned by their member banks.[14] There is no limit to the number of banks that may become members of the Visa or MasterCard network. A member of the Visa or MasterCard network may also be a member of the other network. The member banks in the Visa and MasterCard

8 472 U.S. 585 (1985).
9 *Id.* at 608-10.
10 *Id.* at 606-07.
11 *Id.* at 610-11.
12 344 F.3d 229 (2d Cir. 2003). Kevin represented MasterCard International, Inc. in this litigation. However, the views expressed herein are those of Kevin and Chuck, and do not represent the views of MasterCard or any other client.
13 No. 00-1368, 00-1473, 2003 WL1480498 (3d Cir. March 25, 2003).
14 For simplicity, we use "banks" herein to refer to all the various types of financial institutions that are part of the Visa and MasterCard networks.

networks may operate as "issuers," "acquirers," or both. An "issuer" issues cards to cardholders and serves as a liaison between the network and the individual cardholder. An "acquirer" acquires the card-paid transactions of a merchant and then acts as liaison between the network and the merchants accepting the networks' payment cards with which it has contracted. Card-issuing members compete with each other as well as American Express and Discover to attract individuals to whom they issue cards, choose the features to be offered with each card, select the credit and payment terms and requirements, and bear the credit risk.

Visa and MasterCard operate as non-profit organizations that are funded largely through service and transaction fees paid by member banks. They manage the brand and operate the physical networks for processing card transactions. Visa and MasterCard each have promulgated rules that prohibit its member banks from issuing American Express or Discover Cards, otherwise known as "loyalty rules."

American Express and Discover, the other two major card systems in the United States, are each vertically integrated entities that combine the issuing, acquiring and network functions. (This is often referred to as a "closed loop" system). They deal directly with consumers, to whom they issue cards, and merchants, by acquiring and processing transactions. American Express is the largest issuer of credit and charge cards in the United States, measured by transaction volume.

Changing its long-standing business strategy of a closed-loop system, American Express invited a select group of banks in the Visa and MasterCard networks to issue American Express cards in 1996. Banks refused, some citing the need to convert or sell existing MasterCard and Visa portfolios in light of the loyalty rules. The Department of Justice ("DOJ") challenged the loyalty rules under Section 1, claiming that the rules were a horizontal combination of member banks that unreasonably restrained trade in the market for network services.

After a lengthy bench trial, the Honorable Barbara Jones found that the loyalty rules restrained trade in violation of Section 1.[15] On the issue of consumer harm, Judge Jones found that the loyalty rules "significantly reduced product output and consumer choice in the issuing market and have reduced price competition in the network services market."[16] Interestingly, Judge Jones was able to find that this consumer harm was "undeniable" without being offered *any* actual evidence of such harm by the DOJ.[17] Indeed, the DOJ's expert economist, Professor Michael Katz, never addressed it at all. He submitted over 200 pages of written testimony, none of which address the issue of whether consumers would obtain significantly more cards if the loyalty rules were abolished, or whether consumers would pay lower prices. On cross-examination, Professor Katz agreed that his job was to determine whether the loyalty rules had a negative effect on consumer welfare, however he did not do any empirical analysis to attempt to quantify the consumer harm.[18] The following colloquy from Mr. Katz's cross-examination is illustrative:

> Q: Now, I know from reading your testimony that you believe that your but-for world would have been better for competition than the world we actually have, but I don't find in your report any indication of how much

15 163 F. Supp.2d 322 (S.D.N.Y. 2001).
16 *Id.* at 330.
17 *Id.* at 406.
18 Cross Examination of Michael Katz, July 11, 2000 (Day 18), at pp. 3497-98.

better off or in fact any information from which I might make such a calculations, is that fair?

A: It is correct that I have not included any sort of numerical calculation.[19]

* * *

Q: Now, turning to another point, I looked through your direct testimony, Professor Katz, and I didn't find any attempt by you to quantify the number of cards that you would expect to be issued in the event that the [loyalty] rules were to be eliminated. Am I correct that –

A: Yes, there is no attempt by me to make a prediction about the number of cards, that's correct.[20]

* * *

Q: Let me ask you, have you measured in an empirical way any price increases in this case?

A: In terms of the narrow conception of pricing, how a price change has gone from a particular number of dollars and cents to another, no.[21]

With respect to the DOJ's claim of reduced output of cards as a result of the loyalty rules, Visa and MasterCard argued that American Express and Discover were very successful at reaching consumers other than through the associations' member banks. Judge Jones agreed that this argument was true.[22] Indeed, she found that, despite the loyalty rules, "there are many alternative card distribution channels available to American Express and Discover other than the associations' member banks . . . ."[23] Kenneth Chenault, the Chairman and CEO of American Express, acknowledged that the Company has the ability to reach every American consumer, except maybe those "in the mountains of West Virginia." Judge Jones further found, and the Second Circuit recognized, that "American Express is the largest single card issuer in the United States, as measured by transaction volume . . . [and] Discover is the fifth largest issuer."[24] Moreover, Judge Jones found that consumers have "thousands" of credit card choices and "already [have] plenty of cards and product features."[25]

Nevertheless, she held that the loyalty rules have "hampered" American Express and Discover as networks, which she tied, once again without any empirical evidence, to lessening consumer choice.[26]

The Second Circuit Court of Appeals affirmed Judge Jones' decision.[27] With respect to the issue of harm to competition, the Second Circuit held:

19 *Id.* at p. 3498.
20 *Id.* at July 12, 2000 (Day 19), p. 3728.
21 *Id.* at July 14, 2000 (Day 21), at p. 4053.
22 163 F. Supp.2d at 383.
23 *Id.* at 382-383.
24 344 F.3d 229, 237 (2d Cir. 2003).
25 163 F. Supp.2d. at 383.
26 *Id.*
27 344 F.3d 229. Visa and MasterCard have petitioned the Supreme Court for a writ of certiorari, which request is pending.

> The district court found that Visa U.S.A. and MasterCard's exclusionary rules harm competition by "reducing overall card output and available card features," as well as by decreasing network services output and stunting price competition. We cannot say that these conclusions were erroneous.[28]

The Second Circuit neither mentioned consumer welfare in its opinion, nor appeared to notice that the DOJ had adduced no empirical evidence of consumer harm.

Moreover, the Court ignored its own well-established rule of reason standard. The Second Circuit has squarely held that, with respect to allegations that competitors have been foreclosed or limited in their ability to distribute or market their products, the legal question is whether competitors can reach the ultimate consumer through alternative distribution channels. This rule of law is applicable to both vertical and horizontal restraints.[29] The rationale behind this standard is self-evident: where consumers can avail themselves of the benefits of competitive offerings, the competitive process is functioning, and the courts need not intervene. If they do so, they are merely assisting specific competitors, rather than safeguarding the competitive process for consumers.

While acknowledging that the rule of reason standard applies here, the Second Circuit mistakenly concluded that the level of inquiry required under the rule of reason somehow turns on whether an agreement is appropriately characterized as horizontal or vertical. After concluding that the loyalty rules are horizontal restraints among the member banks, the court summarily concluded "such arrangements are exemplars of the type of anticompetitive behavior prohibited by the Sherman Act."[30] Having concluded that the foreclosure standard set forth in *CDC* and *Clorox* does not apply, the Second Circuit ignored the undisputed evidence that American Express could reach consumers. In doing so, the court effectively applied a *per se* test with respect to consumer harm in the context of joint ventures.

IV. *LEPAGE'S V. 3M*

LePage's is an exclusionary conduct case. Defendant 3M manufacturers, among other things, Scotch brand tape. Until the early 1990s, 3M had more than 90% of the market for brand-name transparent tape. Plaintiff LePage's, an office supply manufacturer, began selling "private label" transparent tape, which is sold under the particular retailer's name, in the 1980s. By 1992, LePage's had captured 88% of the private-label tape market. 3M decided to enter the private label tape market in the early 1990s.

LePage's claimed that 3M used a "monopoly broth" of bundled rebates and exclusive dealing-type arrangements to try to destroy the market for private-label tape and steer customers back to its Scotch brand tape. The bundled rebates allowed customers such as Kmart, Staples and Office Depot to earn cash rebates from 3M if they purchased not only tape, but also products in a number of different product lines. 3M set "targets" for each customer. Failure to reach a target in one product line meant that the customer lost the

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28 *Id.* at 240.

29 *See CDC Techs. v. Idexx Labs., Inc.,* 186 F.3d 74, 80 (2d Cir. 1999) (holding defendant's exclusive distributorships did not cause competitive harm where plaintiff achieved nationwide distribution coverage on its own and its sales increased after alleged restraints were put in place); *Clorox Co.* v. *Sterling Winthrop, Inc.*, 117 F.3d 50, 59 (2d Cir. 1997) (finding a horizontal agreement lawful where plaintiff was free to reach consumers in the marketplace using alternative brands); *North Am. Soccer League v. National Football League*, 670 F.2d 1249, 1259, 1261 (2d Cir. 1982) (analyzing whether joint venture's horizontal rule that prohibited NFL owners from owning teams in other sports leagues resulted in significant foreclosure of competition). *See also SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958, 964-65 (10th Cir. 1994) (holding that Supreme Court precedent involving horizontal joint ventures does not imply any "differing antitrust analysis," and that, as in all rule of reason cases, to be judged anticompetitive the joint venture agreement must "actually or potentially harm consumers"); *U.S. Healthcare, Inc.* v. *Health Source, Inc.*, 986 F.2d 589, 595 (1st Cir. 1993) (assessing harm to consumers from exclusivity provisions of HMO physician contracts under a foreclosure standard).

30 344 F.3d at 242.

rebate across all the product lines. LePage's further claimed that these bundled rebates forced retailers to cease or severely limit their purchases of tape from suppliers other than 3M if they were to have any chance of meeting 3M's targets and, in turn, earning a cash rebate. 3M's plan, according to LePage's, was to drive LePage's out of business and then abandon the private-label tape business, leaving the higher-priced Scotch brand tape as the only tape on the market. By the time of trial, LePage's claimed that it barely was surviving.

A jury returned a verdict against 3M on LePage's claims under Section 2 for monopolization and "attempted maintenance of monopoly power." The District Court granted 3M's motion for judgment as a matter of law on the attempted maintenance claim, but upheld the verdict in all other respects and denied 3M's motion for a new trial.[31] On appeal, the Third Circuit Court of Appeals reversed the District Court's judgment on LePage's Section 2 claim by a divided vote.[32] The Third Circuit granted rehearing *en banc*, withdrew its divided opinion, and affirmed the District Court's judgment.[33] 3M petitioned the Supreme Court for a writ of certiorari, which request was denied on June 30, 2004.

On the issue of anticompetitive effect, consumer harm was never mentioned by the District Court or the Third Circuit Court of Appeals either time it considered the case. At trial, LePage's experts, Ken Baseman and Terry Musika, never opined on whether consumers were harmed, much less to what degree.

In its *en banc* decision, the Third Circuit apparently simply assumed that harm to a competitor, LePage's, necessarily led to harm to competition:

> When a monopolist's actions are designed to prevent one or more new or potential competitors from gaining a foothold in the market by exclusionary, i.e., predatory, conduct, its success in that goal is not only injurious to the potential competitor but also to competition in general. It has been recognized, albeit in a somewhat different context, that even foreclosure of "one significant competitor" from the market *may* lead to higher prices and reduced output.[34]

Although the Third Circuit cited *Aspen Skiing*, stating that it is "pertinent to the case before us," the Court did not appear to notice that plaintiff Aspen Highlands *had, in fact,* introduced evidence of consumer harm, not simply evidence of harm to itself alone.[35]

Nor was LePage's required to prove that 3M priced below its cost and that 3M could later recoup (over 3M's strenuous objections) because the majority held that LePage's had not made a predatory pricing claim.[36] 3M argued that its conduct was legal as a matter of law because it never priced its transparent tape below its cost, LePage's never contested this assertion, and above-cost pricing "is the very conduct that the antitrust laws wish to promote in the interest of making consumers better off."[37] As Judge Greenberg pointed out in his dissent, LePage's economist admitted that LePage's was not as efficient a tape producer as 3M, and LePage's never demonstrated how much it would have to lower it prices to compete with 3M.[38] While a discussion of the heart of 3M's argument is beyond the scope of this paper, this case illustrates the danger that, without a consumer harm

31 No. Civ. A. 97-3983, 2000 WL 280350 (E.D. Pa. March 14, 2000).
32 277 F.3d 365 (3d Cir. 2002).
33 No. 00-1368, 00-1473, 2003 WL 1480498 (3d Cir. March 25, 2003).
34 *Id.* at *15 (emphasis added).
35 *Id.* at *6-*7.
36 *Id.* at *8.
37 *Id.* at *4.
38 *Id.* at *31, *33.

requirement, exclusionary acts towards competitors, which are simply torts, will be brought under the rubric of the antitrust laws.[39] Here, without any evidence that consumers were injured, the most that should have been concluded is that 3M committed a business tort against LePage's.

V. CONCLUSION

We should not lose sight of the fact that consumer welfare is the ultimate objective of the antitrust laws. Requiring empirical evidence of consumer injury will not only carry out the Supreme Court's mandate but, importantly, will force litigants and courts to engage in real-world assessments of various business practices that are grounded in actual market facts. Paying attention to the presence or absence of actual consumer injury is the best way to ensure that pernicious conduct, as opposed to vigorous competition, will be addressed.

39 *See Fishman v. Estate of Wirtz*, 807 F.2d 520, 570 (7th Cir. 1986) (Easterbrook, J., dissenting) ("The foremost scholars of antitrust agree that the laws are designed for the benefit of consumers and should not be used to advance any other interest. . . . These additional objectives do not require fetching humdrum business torts within the reach of antitrust . . .); *see also* Eleanor M. Fox, *What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect,* 70 Antitrust L.J. 371, 382 & n. 32 (2002) ("In the last decade the Supreme Court has said that antitrust cases must be based on market harm, not unfair exclusion, and not even malicious exclusion").