Single-Firm Conduct Working Group
California Law Review Commission Study of Antitrust Law

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Executive Summary

This report discusses possible reforms to the way California antitrust law treats single-firm conduct. Single-firm conduct can be purely unilateral, as when a firm designs its product to exclude rivals, discriminates against its rivals, or refuses to deal with them. Such conduct also can involve an agreement between the firm in question and other firms.

The reforms discussed here would apply throughout the California economy. They are not focused on any particular sector. Sector-specific rules complement the generally applicable rules by addressing specific features of certain sectors that are not adequately covered by those rules.

Section 1 discusses the goals of existing federal antitrust law and what those goals imply for rules regulating single-firm conduct. The fundamental challenge is where and how to draw the line between conduct that is welcomed as a legitimate form of competition and conduct that is anticompetitive and significantly enhances market power.

Section 2 describes U.S. antitrust law regarding single-firm conduct. The primary Federal antitrust law limiting single-firm conduct is Section 2 of the Sherman Act. In 1890 the Sherman Act made it unlawful to “monopolize or attempt to monopolize.” The Federal Trade Commission (“FTC”) Act also reaches single-firm conduct, especially Section 5, which prohibits “unfair or deceptive acts or practices in or affecting commerce.” The FTC Act was passed in 1914 in part to prohibit certain conduct not reached by the Sherman Act.

Section 3 describes California antitrust law regarding single-firm conduct. California has no provision comparable to Section 2 of the Sherman Act. In particular, the Cartwright Act does not reach purely unilateral conduct. Along with many observers, we view this as a fundamental shortcoming of California antitrust law.

Section 4 discusses various ways in which California could update its antitrust law to cover single-firm conduct. One approach would be to enact statutory language similar to that found in Section 2 of the Sherman Act. However, as explained in Section 4.A, without language clarifying that California courts should develop their own jurisprudence defining anticompetitive exclusionary conduct by a single firm, that approach would likely import known shortcomings of Federal law into California law and would likely lead California courts to rely on or follow Federal case law (including widely criticized cases that have weakened the Sherman Act in recent decades) as they interpret the California statute. Section 4.B addresses two recent legislative proposals to strengthen antitrust law toward single-firm conduct, one in the U.S. Congress and one in the New York legislature.

We know from more than a century of experience under the Sherman Act that courts find it very difficult to distinguish single-firm conduct that harms competition from single-firm conduct that constitutes legitimate competition on the merits. The history of federal antitrust enforcement of single-firm conduct illustrates that when courts are uncertain about how to assess conduct, they often find in favor of defendants even if the conduct harms competition simply because the plaintiff bears the burden of proof. More clarity in the statute will likely result in more protection of competition and consumers. The Legislature may therefore want to include language to help the courts distinguish anticompetitive exclusionary conduct from procompetitive conduct. That language can benefit from economic learning and the development of Sherman Act case law.

Section 4.C offers example statutory language by which California could reform its antitrust law to better encompass single-firm conduct. The unifying goal animating these reforms is to prevent anticompetitive exclusionary conduct. A firm is deemed to have engaged in anticompetitive exclusionary conduct if that conduct tends to (a) diminish, or create a meaningful risk of diminishing, the competitive constraints imposed by that firm's rivals and thereby increasing, or creating a meaningful risk of increasing, that firm's market power, and (b) does not provide sufficient benefits to prevent the firm's trading partners (often its customers, but sometimes its suppliers, including workers) from being harmed by the increased market power. The requisite harm to trading partners can be historical, in the future, or both.

1. Goals of the Antitrust Laws

We begin by discussing the goals of the antitrust laws, especially as they relate to single-firm conduct. Understanding these goals is fundamental to any evaluation of how the California antitrust laws are currently working and how they might be reformed.

A. Anticompetitive Conduct is Prohibited

The antitrust laws prohibit anticompetitive conduct, including single-firm conduct by powerful firms, under certain circumstances. These laws are fundamentally about protecting and promoting competition.

While the statutory text of the antitrust laws speaks solely of economic concepts, their passage was motivated in no small part by concerns that concentrated economic power can lead to concentrated political power, which is widely seen as unhealthy in a democracy. Congress and the California legislature also recognized that competitive markets can generate many useful byproducts apart from increased economic growth and greater economic welfare, including a more equal distribution of income and wealth and expanded opportunities for small businesses and entrepreneurs.

However, these broader social and political goals are not reflected in the text of the Sherman Act. On the other hand, Congress and the California legislature have passed many other laws to further these broader social and political goals much more directly. As a result, broader social and political goals are not directly considered when individual antitrust cases are adjudicated. Indeed, doing so would be impractical. Nonetheless, these important values can influence the evidentiary standards that the Legislature instructs the courts to apply when handling individual antitrust cases. For example, the California Legislature could instruct the courts to err on the side of enforcement when the effect of the conduct at issue on competition is uncertain.

B. Possession of a Monopoly is Not Illegal

The antitrust laws reflect the nearly universal view that the public is harmed when a single firm has such tight control over the supply of some product or service that customers have few if any good alternatives to that firm's offerings. Such monopolies can cause a variety of harms, the most visible of which are high prices and restricted choices for customers. Secure monopolists also have dulled incentives to innovate.

Nonetheless, neither Federal antitrust law nor California antitrust law makes it illegal to possess monopoly power or to charge a monopoly price. To the contrary, the Sherman Act condemns the

act of "monopolization" but *not* the possession of a monopoly. For example, a pharmaceutical firm many lawfully obtain a monopoly over a certain patented drug (for some period of time) and may lawfully exercise that monopoly by charging a high price or restricting output of the drug, but it may not engage in anticompetitive conduct that excludes competition from other patented or generic drugs. Similarly, a company may lawfully attain a high market share, even 100% of the market, after it introduces a new product or technology that customers prefer over alternatives.

Given the ills associated with monopoly, it is natural to ask why the antitrust laws do not simply outlaw monopoly. The basic reason is that firms can and do grow to be very large and highly profitable, even to the point of having monopoly power, solely through "competition on the merits," i.e., by offering their customers better value than do their rivals. Neither Congress nor the California legislature has ever wanted to discourage such efforts.[1] They have, however, established sector-specific public utility regulators to supervise industries in which firms are seen to have an unacceptable level of durable monopoly power, perhaps due to economies of scale that lead to a "natural monopoly," to control the exercise of that monopoly power.

C. Implications for Single-Firm Conduct

This overall approach has led to two challenges for antitrust law as regards single-firm conduct. First, the law has struggled to determine which firms have or are likely to obtain sufficient market power that their unilateral conduct is a matter of concern for antitrust purposes. Second, the law must identify the kinds of conduct that are prohibited. The latter requires distinguishing between "competition on the merits," which is legal, and "anticompetitive conduct," which is illegal when it has a sufficient impact on competition.

Although there are many doctrinal complications, as a conceptual matter Federal antitrust law is rather simple. **The law prohibits anticompetitive conduct that causes or is likely to cause a significant increase in market power.** This statement of U.S. antitrust law is attractively concise, but its interpretation hinges very much on how the terms "anticompetitive conduct" and "significant increase in market power" are defined.

A firm has increased market power vis-à-vis a customer if that firm can profitably make a less attractive offer to that customer, such as by charging a higher price or providing a lower quality product. A firm has increased market power vis-à-vis a supplier or worker if that firm can profitably make a less attractive offer to that supplier or worker, such as by paying less to the supplier or the worker or by offering less attractive working conditions. Increased market power means more market power than the firm would have absent the allegedly anticompetitive conduct, not necessarily more than in the past. For example, a firm can gain increased market power by preventing a decline in its market power that would otherwise take place.

[1] Judge Learned Hand famously captured this idea in United States v. Aluminum Company of America (148 F.2d 416, Second Circuit [1945]): "A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry. In such cases a strong argument can be made that, although the result may expose the public to the evils of monopoly, the Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: *finis opus coronat*. The successful competitor, having been urged to compete, must not be turned upon when he wins."

Anticompetitive conduct is conduct that tends to weaken the competitive discipline provided by rivals and thereby increases the defendant's market power and does not provide sufficient offsetting benefits to trading partners, such as by increasing product quality, promoting innovation, or lowering prices. Note that the very definition of "anticompetitive conduct" involves a potentially difficult balancing of benefits and harms.

The competitive discipline provided by rivals can be weakened in two ways. The first is when firms that are actual or potential rivals agree to collaborate instead of competing. This is often called "collusion." Some kinds of "collusion," such as mergers or joint ventures among firms with little or no market power, are not anticompetitive. By way of contrast, cartels and price fixing agreements are *per se* illegal under both Federal and California law. The second is when one or more firms takes actions that drive out of the market or weaken other firms that would otherwise be actual or potential competitors. This is often called "exclusion." Some kinds of "exclusion," such as inventing a new and better product, are not anticompetitive. But some kinds of exclusion, such as exclusive dealing agreements or loyalty discounts, can be anticompetitive.

Our focus here is on single-firm anticompetitive conduct that is exclusionary. In this report, we refer to such conduct as "anticompetitive exclusionary conduct."

In practice, identifying single-firm anticompetitive exclusionary conduct is far from straightforward. Litigating parties typically disagree about whether the conduct will weaken the competitive discipline provided by rivals. They also invariably disagree about whether the challenged conduct is likely to harm the defendant's trading partners. Courts rarely find conduct that both tends to weaken the competitive discipline provided by rivals *and also* provides some benefits to trading partners. When they do encounter such conduct, they often find that the benefits could have been achieved by means that are less harmful to competition, so those benefits do not justify the conduct. When courts find conduct that both weakens the competitive discipline of rivals and is reasonably necessary to provide benefits to trading partners, they have difficulty evaluating it. These issues are inherently complex, in part because there are many forms of anticompetitive and procompetitive conduct and many distinct market settings in which they arise. As a result, a great deal hinges on the guidance that the legislature and the higher courts provide to the trial courts. Furthermore, the evidence presented in court often is mixed, so the allocation of the burden of proof can determine the outcome.

2. Federal Antitrust Law Regarding Single-Firm Exclusionary Conduct

This report addresses single-firm anticompetitive exclusionary conduct. Such conduct can be purely unilateral, as when a firm designs its product to exclude rivals, discriminates against its rivals, or refuses to deal with them. Such conduct also can involve an agreement between the firm in question and other firms. For example, a manufacturer might enter into an exclusive dealing arrangement with an input supplier that prohibits that input supplier from selling to other manufacturers in a designated area or line of business. Such an exclusive dealing agreement could harm competition by denying rivals of the manufacturer access to an important input. For that reason, in some circumstances prohibiting the manufacturer from requiring exclusivity as a condition of buying the input can lead to more competition, to the benefit of consumers.

Single-firm anticompetitive exclusionary conduct by firms with substantial market power is generally prohibited by Section 2 of the Sherman Act, 15 U.S.C. § 2. Section 2 makes it illegal

for a firm "to monopolize" any part of "trade or commerce."[2] Section 2 has long been construed to prohibit anticompetitive conduct by a single firm that causes it to obtain monopoly power or that creates a "dangerous probability" of obtaining monopoly power in an antitrust market or protects such power from erosion by new entry or the success of smaller rivals. Under Federal law, monopoly power means substantial market power.

Anticompetitive exclusionary conduct that involves an agreement between the target firm and other firms can also violate Section 1 of the Sherman Act, 15 U.S. § 1, which prohibits contracts or conspiracies "in restraint of trade." By contrast to Section 2, however, Section 1 requires proof of just market power, not monopoly power.

California antitrust law is, of course, distinct from Federal antitrust law. In order to protect its citizens, California may want to enact antitrust laws that are different from the Federal antitrust laws. Indeed, the California Supreme Court has indicated that the Cartwright Act is "broader in range and deeper in reach" than federal antitrust law.[3] Furthermore, the U.S. Supreme Court has ruled that state antitrust rules can be broader or stricter than federal rules without raising preemption concerns since "Congress intended the federal antitrust laws to supplement, not displace state antitrust remedies."[4] Nonetheless, it is important to understand how the Federal case law has evolved, so one can identify the ways in which California might follow Federal law, build upon it, or depart from it.

A. How Courts Assess Allegedly Unlawful Conduct: The Rule of Reason

The Federal antitrust laws do not enumerate the various means of excluding competitors. Commercial and technological changes over time and entrepreneurial creativity imply a continually evolving and expanding inventory of potentially exclusionary conduct.[5]

The U.S. Supreme Court has said that monopolization involves "the willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."[6]

As a general matter, allegations of anticompetitive exclusionary conduct are evaluated by a so-called "rule of reason." While the courts have used varying phraseology to describe the rule of reason, there is very wide agreement that the rule of reason means the following.

1. First, the plaintiff must show that the conduct in question has an anticompetitive effect, i.e., causes a significant increase in market power, or is reasonably likely to do so in the future.
2. Second, if the plaintiff meets that burden, the defendant may shift the burden back to the plaintiff by demonstrating a procompetitive justification for its conduct, i.e., "a

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[2] Section 2 also makes it unlawful for a person "to combine or conspire with another person" to monopolize any part of commerce.

[3] *In re Cipro Cases I & II*, 61 Cal. 4th 116, 160-61 (2015).

[4] *California v. ARC Am. Corp.,* 490 U.S. 93,102 (1989).

[5] See, e.g., *United States v. Microsoft Corporation*, 253 F.3d 34, 58 (D.C. Cir. 2001) (en banc) ("the means of illicit exclusion, like the means of legitimate competition, are myriad").

[6] *United States v. Grinnell Corp*., 384 U.S. 563, 571 (1966).

nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal."[7]

3. Third, if the defendant is able to demonstrate a procompetitive justification for its conduct, the plaintiff may rebut that assertion by proving that the procompetitive benefits could largely have been achieved by conduct that was less harmful to competition.
4. Fourth, if the court finds both that the conduct enhanced the defendant's monopoly power and that it was reasonably necessary to achieve procompetitive benefits, then the court should balance the harm and the benefits. To prevail, "the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit."[8]

Two conclusions can be drawn from this formulation of the rule of reason. First, if the conduct is not shown to have injured or be likely to injure competition, then the plaintiff will fail at Step #1 and there will be no violation. Second, if the conduct has injured competition or is likely to do so, and if the defendant cannot demonstrate that the conduct is reasonably necessary to achieve procompetitive benefits, the plaintiff will prevail and the conduct will be found to be illegal.

The result is less clear when evaluating conduct that *both* injures competition and provides valuable benefits. Typically, there is no easy way for the courts to weigh the anticompetitive harms against the procompetitive benefits.

B. Specific Rules for Particular Modes of Conduct

Over time, the Federal courts have developed a number of specific rules applicable to particular kinds of potentially exclusionary conduct. As will be discussed, importing into California law all of the rules that have been adopted by the U.S. Supreme Court to interpret Section 2 of the Sherman Act would be inconsistent with preserving vigorous competition in California.

Specific rules in effect embody a weighing of the benefits and harms for the particular categories of conduct to which they apply. For example, the United States Supreme Court has held that low prices are lawful if the prices remain above cost. Although the Supreme Court acknowledged that aggressive price cuts can harm competition even if the prices remain above cost, it reasoned that a rule that required courts to make case-by-case determinations of the lawfulness of above-cost prices would lead to too many mistakes and uncertainty about the law and would thus deter desirable price reductions.[9] Thus, under federal antitrust law, a plaintiff asserting a claim for predatory pricing must show that the defendant's prices are below cost and that the market structure is such that the defendant has a reasonable probability of recouping its losses from below-cost sales once rivals are driven from the market. However, the continued usefulness of the federal predatory pricing rule is questionable when we observe that a rule created thirty years ago, when the digital economy was in its infancy, is poorly suited to products and services with very low or zero marginal costs, as it immunizes virtually all prices from predation claims for such products.

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[7] *United States v. Microsoft Corp*., 253 F.3d 34, 59. (D.C. Cir. 2001) (en banc).

[8] See, e.g., *United States v. Microsoft Corp*., 253 F.3d 34, 59 (D.C. Cir. 2001) (en banc).

[9] *Brooke Group v. Brown & Williamson Tobacco*, 509 U.S. 209 (1993).

Another example is the United States Supreme Court's decision that even a monopolist can normally choose the parties with which it will deal and that a monopolist's selective refusal to deal with another firm, even a competitor, violates antitrust law only in unusual circumstances. As with predatory pricing, the Court acknowledged that selective refusals to deal can be anticompetitive, but it explained that courts are ill-equipped to determine the terms on which one firm should be required to deal with another, so a bright line is necessary to preserve the incentives of both the monopolist and the competitor to compete aggressively in the marketplace.[10] Such a rule may have been reasonable in a setting where "dealing" often meant incurring a large fixed cost to coordinate with the other firm. In an economy containing digital "ecosystems" that connect many businesses to one another, and digital markets with standardized terms of interconnection, such as established application program interfaces (APIs), that rule may immunize much conduct that could be anticompetitive.

The Federal courts have created numerous other specific rules relating to single-firm conduct. Many of them were controversial from the start. Others have become more controversial as they have become outmoded. There have been numerous proposals to revise them by judicial decisions or new legislation. We discuss some of these proposals below.

Even taken together, all of these specific rules cover only a portion of the kinds of conduct that might violate the antitrust laws. Conduct that is not subject to one of the specific rules is assessed by application of the general principles embodied in the rule of reason.

C. Harm to Competition vs. Harm to Competitors

Many cases involving anticompetitive exclusionary conduct are brought by the defendant's vanquished rivals. Typically, the plaintiff alleges that the defendant's conduct has impaired the ability of one or more rivals to compete and, as a result, has created or maintained its monopoly and has thus injured competition. In response, the defendant argues that it won in the market fair and square by competing on the merits.

Faced with these dueling narratives, courts have come to recognize that a plaintiff's lack of success in the market may result from anticompetitive exclusionary conduct, from legitimate competition, or from a combination of the two. Therefore, the plaintiff's lack of success in the market, *in and of itself*, does not indicate that the defendant engaged in anticompetitive exclusionary conduct. Furthermore, it would be antithetical to the goals of the antitrust laws to punish successful firms that competed on the merits merely because their success harmed their rivals. The mantra that captures this important idea is that "the antitrust laws protect competition, not competitors."[11]

This mantra is useful but it has been interpreted too expansively by defendants. Critically, in cases involving anticompetitive exclusionary conduct, the mechanism by which competition is harmed *is* the weakening of rivals. For this reason, evidence that one or more rivals was weakened by the challenged conduct is highly relevant for assessing harm to competition, if the conduct was indeed anticompetitive rather than procompetitive. A court can accept and understand this point and still conclude, perhaps easily and quickly, that certain challenged

[10] *Verizon Communications v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (2004).

[11] For example, the DC Circuit has stated that an antitrust plaintiff "must demonstrate that the monopolist's conduct harmed competition, not just a competitor." *United States v. Microsoft Corp*., 253 F.3d 59 (2001).

conduct, such as unadorned product improvement, did harm the plaintiff but was nonetheless not anticompetitive because it provided offsetting benefits to the defendant's customers.

3. California's Antitrust Laws and Single-Firm Conduct

We discuss three statutes, which together comprise California's antitrust laws. For a highly informative and thorough discussion of California's antitrust laws, see *California Antitrust and Unfair Competition Law*, Antitrust Section of the California Lawyers Association.[12] In this report, we refer to this authority as the *California Antitrust Law Treatise*.

A. The Cartwright Act

California's principal antitrust statute is the Cartwright Act, codified in California Business and Professional Code Sections 16700 to 16770.

1. History and Purpose

When originally enacted in 1907, the California Legislature described the purpose of the Cartwright Act as follows:

> "An Act to define trust and to provide the criminal penalties and civil damages, and punishment for corporations, persons, firms, and associations, or persons connected with them, and to promote free competition in commerce and all classes of business in the state."[13]

California courts have stated: "The purpose of the Cartwright Act is to protect and foster competition by preventing combinations and conspiracies which unreasonably restrain trade."[14] The Cartwright Act "generally outlaws any combinations or agreements which restrain trade or competition or which fix or control prices."[15]

The California Supreme Court extensively discussed the historical context and legislative history of the Cartwright Act in the case of *State ex. rel. Van de Kamp v. Texaco, Inc.,* 46 Cal. 3rd 1147 (1988) (*Texaco*). In that case, the California Supreme Court noted that the Cartwright Act was not modeled after the federal Sherman Act (15 U.S.C. § 1, 2) but rather was modeled after the antitrust laws of Texas and Michigan.[16]

The California Supreme Court case of *Clayworth v Pfizer, Inc.,* 49 Cal. 4th 758 (2010), provides support for the proposition that the Cartwright Act favors over-deterrence to under-deterrence. In that case, the Court rejected the argument that defendants in a price-fixing conspiracy case could raise a defense that the plaintiffs had passed-on all alleged overcharges, thus exposing the

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[12] *California Antitrust and Unfair Competition Law,* Belinda S. Lee, ed., Antitrust & Unfair Competition Law Section, California Lawyers Association, Revised Edition, Mathew Bender & Co., 2022.

[13] 1907 Cal. Stats. Ch. 530, p. 984.

[14] *Morrison v. Viacom, Inc.,* 52 Cal. App. 4th 1514, 1524 (1997).

[15] *PG&E Co. v. County of Stanislaus*, 16 Cal. 4th 1143, 1147 (1997).

[16] As the California Supreme Court confirmed in the later case of *Aryeh v. Canon Bus. Sols., Inc.,* 55 Cal. 4th 1185, 1195 (2013), "[i]nterpretations of federal antitrust law are at most instructive, not conclusive, when construing the Cartwright Act, given that the Cartwright Act was modeled not on federal anti-trust statutes but instead on statutes enacted by California's sister states around the turn of the 20th Century."

defendants to multiple damages claims from different classes of plaintiffs, on the ground that the Legislature had amended the Cartwright Act to allow indirect purchasers to sue and also to allow the Attorney General to bring a *parens patriae* suit on behalf of in-state consumers. The Court stresses the goal of maximum deterrence:

> "In divining the Legislature's intent, we consider as well overarching legislative goals evident from the Legislature's adoption and amendment of the Cartwright Act over the years. From its inception, the Cartwright Act has always been focused on the punishment of violators for the larger purpose of promoting free competition. …. As the Cartwright Act's primary concern is with the elimination of restraints of trade and impairments of the free market, we can and should select the damages rule most consistent with that focus. The goal of deterring antitrust violations and concerns that a given private party may receive a windfall are not of equal weight. The Legislature's adoption of a double damages remedy … later amended to treble damages … demonstrates as much: double and treble damages may overcompensate injured plaintiffs, but they do so in order to maximize deterrence." (49 Cal. 4th at p.783-784)

2. Main Statutory Provisions

The Cartwright Act's main prohibitions are set forth in Business and Professions Code Sections 16726 and 16720. Section 16726 prohibits "trusts," declaring that, unless exempted, "every trust is unlawful, against public policy and void."[17]

Section 16720 defines the term "trust" to mean "a combination of capital, skill or acts by two or more persons" for any of the purposes delineated in the statute, including combinations " to create or carry out restrictions in trade or commerce," or "to limit or reduce the production, or increase the price of merchandise or any commodity." The provisions of Section 16720 have been interpreted to prohibit price-fixing, exclusive dealing, tying, market allocations, bid-rigging, and group boycotts through "concerted action."

Like the Federal antitrust laws, the Cartwright Act allows plaintiffs to recover treble damages and attorneys' fees.

3. Failure to Reach Purely Unilateral Conduct

In the *Texaco* case, the California Supreme Court concluded that the term "combination" in Section 16720 was intended to apply only to entities that continue as separate, independent entities during and after their collusive action.[18]

In the light of the requirement that there be a "combination" or "concerted action" by two or more independent entities, a number of commentators and courts have declared that the Cartwright Act does not reach purely unilateral behavior by a single firm. A California Court of Appeal stated in the case of *Asahi Kasei Pharma Corporation v. Cotherix, Inc.,* 204 Cal. App.

[17] Cal. Bus. & Prof. Code § 16726.

[18] *Texaco*, 46 Cal. 3rd at 1163. Thus, in *Texaco*, the Supreme Court held that the Cartwright Act should not be interpreted to apply to the acquisition of one firm by another, i.e., to mergers.

4th 1, 8 (2012), that "[t]he Cartwright Act bans combinations, but single firm monopolization is not cognizable under the Cartwright Act."[19]

The *California Antitrust Law Treatise* states: "[T]he Cartwright Act contains no analogue to Section 2 of the Sherman Act, which addresses single firm (as opposed to multiple firm) conduct… The California appellate courts and federal courts have concluded that the Act …does not apply to unilateral behavior by a single firm."[20] Other California and federal decisions are in accord.[21] Another commentator notes: "Consistent with the need for cooperative action, single-firm monopolization conduct cannot serve as an offense under the Act, although a multi-firm conspiracy to monopolize likely would."[22]

Accordingly, several types of single-firm conduct that are covered by Section 2 of the Sherman Act are not covered by the Cartwright Act, including unilateral refusals to deal, discrimination against rivals, tortious conduct that disrupts the ability of a rival to compete effectively, and sham litigation.

B. Unfair Competition Law (UCL)

California's Unfair Competition Law, Business and Professions Code Section 17200-17210, (UCL law or Section 17200) allows a claim by an injured competitor or consumer based on any unlawful, unfair, or fraudulent business practice.

A claim under the "unlawful" prong of Section 17200 may be based on a violation of any federal or state law, including Section 2 of the Sherman Act, so some single-firm conduct might be challenged as a violation of Section 17200.[23] Some single-firm conduct might also be challenged as "unfair" in a Section 17200 claim.

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[19] See also *Dimidowich v. Bell & Howell,* 803 F.2d 1473 (9th Cir. 1986), modified on other grounds, 810 F.2d 1517 (9th Cir. 1987) (Claim for unilateral conduct under the Cartwright Act is not cognizable, "for it fails to allege any combination".

[20] Sec.1.01[C] at p. 1-5 to 1-6.

[21] See *Freeman v. San Diego Ass'n Realtors,* 77 Cal. App. 4th 171, 200 n.. 32 (1999) (The Cartwright Act bans combinations but does not have any parallel to Sherman Act section 2's anti-monopoly provisions."); *Flagship Theaters of Palm Desert LLC v. Century Theaters, Inc.*, 198 Cal. App. 4th 1366, 1386 (2011) ("[T]he Cartwright Act contains no provision parallel to the Sherman Act's prohibition against monopolization (15. U.S.C. § 2), and the Cartwright Act applies only to a 'combination' involving 'two or more persons' (§ 16720), not to *unilateral* conduct."); *Freehand Corp. v. Adobe,* 852 F.Supp.2d 1171, 1185 (N.D. Cal. 2012) (ruling that the Cartwright Act does not address unilateral conduct); *In re NFL Sunday Ticket Anti-Trust Litigation,* 2016 U.S. Dist. LEXIS 41639 at *12-13 (C.D.Cal.Mar. 28, 2016)(ruling that unilateral monopolistic conduct was not actionable under the Cartwright Act); *but see Lowell v. Mother's Cake & Cookie Co., 79* Cal. App. 4th 13 (1979) (noting in dicta that monopoly is a prohibited "restraint of trade" under the Cartwright Act, but rejecting the monopolization claim because the plaintiff had failed to allege that the defendant had acquired a monopoly, and because the alleged injury did not flow from the alleged monopolization.)

[22] John M. Landry and Kirk A. Hornbeck, "100 years in the Making: The Cartwright Act in Broad Outline", *Competition*, Vol. 17, No. 2, p. 7, 10 (Fall 2008).

[23] See *Aya Healthcare Services, Inc. v. AMN Healthcare, Inc*., 2018 U.S. Dist. LEXIS 102582 at *69 (S.D. Cal. 2018) ("Because Plaintiffs allege unlawful conduct under Section 1 and Section 2 of the Sherman Act, Plaintiffs also adequately allege a violation of the UCL's unlawful prong.") But see *People's Choice Wireless, Inc. V. Verizon Wireless*, 131 Cal. App. 4th 656 (2005) (rejecting UCL claim based on defendant's alleged "refusal to deal" claim based on analysis of federal Section 2 caselaw).

In a case brought by a competitor (as opposed to a consumer), the courts have ruled that "unfair" should apply to "conduct that threatens an incipient violation of an antitrust law, or violates the policy or spirit of one of those laws because its effects are comparable to or the same as a violation of the law, or otherwise significantly threatens or harms competition." *Cel-Tech Commc'ns v LA Cellular*, 20 Cal. 4th 163,187 (1999). It is not clear from the statute or the cases what "an incipient violation" or conduct that "violates the spirit or policy" of the antitrust laws means with respect to conduct that does not violate those laws. However, a recent federal appellate decision affirmed a ruling that a challenged practice could be "unfair" within the meaning of Section 17200 even where the district court found that the practice did not violate Section 1 or Section 2 of the Sherman Act, since it deprived consumers of important information that would promote competition.[24]

In cases brought by consumers under Section 17200, courts have applied varying tests of what is "unfair", including a test based on the FTC's definition of "unfair" under Section 5 of the FTC Act, a test applying a form of cost-benefit analysis weighing "the utility of the defendant's conduct against the gravity of the harm to the alleged victim", or a requirement that the allegedly unfair business practice be 'tethered' to some legislatively declared policy or proof of some actual or threatened impact on competition.[25]

However, while the reach of the UCL is broad, there are significant limitations to utilizing Section 17200 as a vehicle to attack exclusionary single-firm conduct. Significantly, compensatory damages are not available in private actions under the UCL, only restitution and injunctive relief. Restitution involves an Order "compelling a UCL defendant to return money obtained through an unfair business practice to those persons in interest from whom the property was taken." See *Korea Supply v Lockheed*, 29 Cal 4th 1134 (2003) (profits obtained by one company which secured a contract by bribes not recoverable from rival which bid for contract). Thus, a successful plaintiff cannot recover damages based on a UCL claim. Nor are attorney's fees automatically recoverable, in contrast to a Cartwright Act claim. Further, because a Section 17200 claim is equitable in nature, there is no right to a jury trial.

C. Unfair Practices Act (UPA)

The Unfair Practices Act (UPA), codified in California Business and Professions Code Sections 17000 to 17101, includes broad prohibitions against certain below-cost pricing, secret rebates, locality discrimination, and loss leaders. Chapter 18 in the *California Antitrust Law Treatise* covers the Unfair Practices Act.

Section 17040 forbids "locality discrimination," meaning a seller selling an item for different prices at different locations within the State. Section 17043 prohibits below-cost sales "for the purpose of injuring competitors or destroying competition." Section 17044 condemns "loss leaders," meaning the sale of an item below cost for the purpose of inducing the sale of other products with the purpose of injuring competitors or destroying competition. Section 17045 prohibits secret rebates or unearned discounts "to the injury of a competitor and where such payment or allowance tends to destroy competition."

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[24] *Epic Games, Inc. V. Apple, Inc.*, 67 F. 4th 946 (9th Cir. 2023).

[25] See generally California Antitrust Law Treatise Section 16.04[C][2].

These provisions were enacted at different times and are subject to different requirements, intent standards, and defenses. Several of these provisions were enacted in the 1930s during the Great Depression to protect "smaller, independent retailers" from what were considered at the time to be unfair practices by larger "chain stores."[26]

The express purpose of the UPA "is 'to safeguard the public against the creation or perpetuation of monopolies.'"[27] The Legislature specifically declared that the purpose of the UPA is to encourage fair competition "by prohibiting unfair, dishonest, deceptive, destructive, fraudulent and discriminatory practices by which fair and honest competition is destroyed or prevented."[28] The Legislature further mandated that the UPA "shall be liberally construed."[29] The UPA provides for a private right of action with mandatory trebling of damages and attorneys' fees to a successful plaintiff.[30]

Thus, the UPA covers one category of single-firm conduct, predatory pricing, where a claim under Section 2 of the Sherman Act might well not succeed. As noted above, to prevail in a federal predatory pricing case under Section 2, a plaintiff must show (1) that a defendant's prices were below "an appropriate measure" of its costs, and (2) that the defendant had a reasonable prospect of recouping its costs by raising prices after rivals were driven from the market.[31]

According to the *California Antitrust Law Treatise,* "The standards for finding a violation of below-cost pricing under Section 17043 of the UPA are lower in important respects than the standards for predatory pricing and related conduct under Section 2 of the Sherman Act."[32] More specifically: "The differences between federal and California predatory pricing law are most stark when calculating the defendant's costs, the starting point for any determination of below-cost pricing. The UPA explicitly requires courts to apply an average total cost measure."[33] This measure of costs includes not only costs directly associated with the product or service, but also all forms of overhead of the business. By way of contrast, the Federal standard in the Ninth Circuit is to use average variable cost.

Moreover, California courts have ruled that to prevail under Section 17043, a plaintiff need not prove the defendant had the ability to recoup its losses, as required under federal law.[34] However, a defendant may rebut a UPA claim by establishing one of the statute's affirmative defenses,

[26] *ABC Int'l Traders v. Matsushita Elec. Corp.,* 14 Cal. 4th 1247, 1261 (1997).

[27] *Cel-Tech Commc'ns, Inc. v. L.A. Cellular Tel. Co.,* 20 Cal. 4th 163, 179 (1999) (quoting Cal. Bus & Prof. Code § 17001).

[28] Cal. Bus. & Prof. Code sec. 17001.

[29] Cal. Bus. & Prof. Code sec. 17002.

[30] Cal. Bus. & Prof. Code sec. 17082.

[31] *Brooke Group Ltd. v. Brown & Williamson Tobacco Co*., 509 U.S. 209 (1993).

[32] See Chapter 6.

[33] See Chapter 6.

[34] *Bay Guardian Co. V. New Times Media LLC*, 187 Cal. App. 4th 438, 454-55 (2010); see also, *Rheumatology Diagnostics Lab. Inc. V. Aetna, Inc.,* 2013 U.S. Dist. LEXIS 151128 at*57 (N.D. Cal. 2013).

such as ”meeting competition”, or by showing that the sales were made in good faith and not for the purpose of injuring competitors or destroying competition.[35]

4. Updating California Antitrust Law to Reach Purely Unilateral Conduct

The most glaring deficiency in the Cartwright Act is its failure to reach purely unilateral conduct. This section offers a number of suggestions for how the Legislature could update California law to make it illegal for firms and other private entities to engage in single-firm conduct that causes significant harm to competition.

A. Using Language Similar to Section 2 of the Sherman Act

One way to reach purely unilateral conduct would be to add to California law a provision similar to Section 2 of the Sherman Act, which prohibits monopolization and attempted monopolization. For example, the Legislature could amend Section 16720, or add a new Section, which reads:

> “(a) It is unlawful for one or more persons to monopolize, attempt to monopolize, or to combine or conspire with another person or persons to monopolize any part of trade or commerce within the State, and such activity is a ‘trust’ for the purposes of this Act.” (b) As used in this Act, “monopolize” includes “monopsonize.”[36]

However, while adding such language would be an important starting point, without further elucidation, using language that mimics the Sherman Act would come with a potentially severe disadvantage: California state courts might then believe that they should apply 130 years of federal jurisprudence to cases brought under California state law. In recent decades, that jurisprudence has substantially narrowed the scope of the Sherman Act, as described above, so relying on it could well rob California law of the power it needs to protect competition. This drawback is accentuated if California seeks to enact stronger antitrust laws to protect its citizens than has the United States.

B. Two Recent Legislative Proposals

We note two recent legislative proposals relating to the treatment of single-firm conduct.

First, there have been some recent efforts in Congress to amend Section 2 of the Sherman Act to correct some of its perceived problems. Most notable is S.225, the “Competition and Antitrust Law Enforcement Reform Act of 2021,” (CALERA). CALERA was introduced in February 2021 by a group of Senate democrats led by Senator Klobuchar (D-MN). A number of its provisions were drafted to overrule specific Supreme Court cases that weakened antitrust

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[35] See generally Ryan Sandrock and Stephen Chang, ”Below-Cost Pricing: Recent Defense-Friendly Decisions”, Antitrust & Competition Law 26(1), Spring 2017.

[36] Very similar language was proposed in California Senate Bill No. 1274 (Cal. Leg. Session 2006-2007), introduced in 2006. That bill, which also included language which would have changed the standard for obtaining summary judgment in antitrust cases, failed to pass the Legislature. Earlier efforts to incorporate language similar to Section 2 of the Sherman Act into the Cartwright Act also failed to pass, but in each case the proposed law included other provisions to which objections were raised. See Sen. Bill No. 1814 (Cal. Leg. Session 2001-2002) and Assembly Bill No. 671 (Cal. Leg. Session 1989-1990).

enforcement. The most relevant portion of CALERA is Section 9, "Exclusionary Conduct." This bill has not been enacted.

Second, the New York legislature has repeatedly considered modifying New York antitrust law, most recently in the form of the "Twenty-First Century Anti-Trust Act. This bill would make it unlawful for any firm with a "dominant position" in any market to abuse that position. The term "dominant position" is defined very broadly. That bill was criticized by the New York City Bar Association and the Antitrust Section of the American Bar Association and has not been enacted.

"Abuse of dominance" has never been recognized as an offense in the United States. Such an offense is included in EU competition law, but it has been only rarely enforced because of its unavoidable ambiguity. The New York bill does not avoid this ambiguity. It provides that "abuse of a dominant position may include, but is not limited to, conduct that tends for foreclose or limit the ability or incentive of one or more actual or potential competitors to compete." The bill might thus be understood to prohibit desirable, procompetitive conduct such as designing a better product or developing a more efficient means of distribution when doing so harms competitors or reduces their incentives to compete. In fact, unlike European law, the bill expressly provides that "evidence of pro-competitive effects" is not a defense to an abuse of dominance.

These provisions seem intended to protect competing businesses, even at the expense of consumers and workers. We therefore do not believe that the New York bill provides a good model for California.

C. Example Statutory Language Covering Single-Firm Conduct

In addition to amending the Cartwright Act to cover purely unilateral conduct, the Legislature could adopt new general language, not derived from or reliant on Section 2 of the Sherman Act, to make clear that the standard it lays down for single-firm conduct is distinct from the Federal standard. The Legislature also could adopt specific language to address various modes of single-firm conduct where the Federal courts have narrowed the reach of the Sherman Act. Both approaches would help the California State courts avoid numerous pitfalls in Federal law and thereby more effectively protect competition.

The Legislature could speak plainly and directly by prohibiting anticompetitive exclusionary conduct by a single firm, taking care to distinguish such conduct from legitimate methods of competition. The remainder of this section offers example statutory language.

Preamble and Legislative Findings

The Cartwright Act has been interpreted to apply only to anticompetitive conduct of two or more separate economic entities through "concerted action," not to anticompetitive exclusionary conduct of a single firm. In order to protect and foster competition within the State, the Legislature has determined that it is necessary to amend and supplement the Cartwright Act to make clear that it also proscribes anticompetitive exclusionary conduct by a single person or firm, as set forth below.

Whereas, condemning anticompetitive exclusionary conduct by which a single person (as defined in Bus. & Prof. Code Section 16702) monopolizes or otherwise significantly harms competition with respect to any part of the trade or commerce within the State is consistent with

the over-arching goal of the Cartwright Act to promote and protect competition. Such conduct may be referred to as "single-firm anticompetitive exclusionary conduct."

Whereas, the California Supreme Court has determined that the Cartwright Act is "broader in scope and deeper in reach" than the federal Sherman Act, and whereas the Legislature deems Section 2 of the Sherman Act as construed by the federal courts to be under-inclusive of single-firm anticompetitive exclusionary conduct, courts interpreting this Section should not be bound by federal precedent interpreting Section 2 of the Sherman Act, and should make their own determinations of whether challenged conduct by a single firm violates the law.

Whereas the policy of California is that the public is best served by competition and the goal of the California antitrust laws is to promote and protect competition throughout the State, in interpreting this Section courts should bear in mind that the policy of California is that the risk of under-enforcement of the antitrust laws is greater than the risk of over-enforcement.

Whereas, the Legislature recognizes that it is sometimes difficult for courts to distinguish between anticompetitive exclusionary conduct, which is illegal, from competition on the merits, which is legal even if it weakens rivals or drives them out of business altogether, the Legislature hereby provides certain guidance to the courts by describing a number of modes of single-firm conduct which can be anticompetitive, depending on the circumstances. The following list is illustrative, not exhaustive.

> **Loyalty Rebates**, which penalize a customer that conducts more business with the defendant's rivals, as opposed to volume discounts, which are generally procompetitive;
>
> **Exclusive Dealing Provisions**, which disrupt the ability of counterparties to deal with the defendant's rivals, especially if such provisions are widely used by the defendant;
>
> **Most-Favored Nation Clauses**, which prohibit counterparties from dealing with the defendant's rivals on more favorable terms and conditions than those on which they deal with the defendant, especially if such clauses are widely used by the defendant;
>
> **Discrimination Against Rivals**, for example by refusing to provide rivals of the defendant access to a platform or product or service that the defendant provides to other third-parties, as opposed to a firm choosing not to provide access or interconnection to any third-party;
>
> **Agreements to Limit Competition**, such as settlements of patent infringement cases brought by pharmaceutical firms against alleged generic entrants in which the patent holder provides valuable consideration to the potential generic entrant and that party agrees to restrictions on its ability to compete against the patent holder;
>
> **Predatory Pricing**, including targeted discriminatory pricing aimed at particular rivals to weaken them or drive them from the market, recognizing that the "recoupment" requirement for a predatory pricing claim under federal antitrust law is not a requirement under California law.

The Legislature hereby amends the Cartwright Act as follows:

Section 16720.1

(a) It is unlawful for one or more persons to engage in anticompetitive exclusionary conduct that affects any part of the trade or commerce within the State. Furthermore, any violation of Section 2 of the Sherman Act shall be deemed a violation of this Act.

(b) Conduct, whether by one or multiple actors, is deemed to be anticompetitive exclusionary conduct, if the conduct tends to

(1) diminish or create a meaningful risk of diminishing the competitive constraints imposed by the defendant's rivals and thereby increase or create a meaningful risk of increasing the defendant's market power, and

(2) does not provide sufficient benefits to prevent the defendant's trading partners from being harmed by that increased market power.

(c) "Trading partners" are parties with which the defendant deals, either as a customer or as a supplier. In (b), a trading partner is deemed to be harmed or benefited even if that trading partner passes some or all of that harm or benefit on to other parties.

(d) The defendant's conduct has increased market power vis-à-vis a customer if the defendant can profitably make a less attractive offer to that customer, such as by charging a higher price or providing a lower quality product, than the defendant could absent that conduct. The defendant's conduct has increased market power vis-à-vis a supplier or worker if the defendant can profitably make a less attractive offer to that supplier or worker, such as by paying less to the supplier or the worker or by offering less attractive working conditions, than the defendant could absent that conduct.

(e) Anticompetitive exclusionary conduct includes conduct that has or had a material risk of harming trading partners due to increased market power, even if those harms have not yet arisen and may not materialize.

(f) The following additional factors are to be used in determining whether conduct in (b) is anticompetitive exclusionary conduct.

1) Increased market power in b(1) and the benefit and harm to trading partners in b(2) are evaluated by comparing the market outcome including the conduct with a reasonably likely market outcome without the conduct. A firm can gain increased market power by preventing a decline in its market power that would take place if the defendant had not undertaken the conduct.

2) Neither the diminished competitive constraints in b(1) nor the harm to counterparties in b(2) need be immediate or certain. It is sufficient that the allegedly anticompetitive conduct creates a material risk of diminished competitive constraints in the future. The diminishment is evaluated relative to the competitive constraints that rivals would impose absent the defendant's conduct.

3) The competitive constraints imposed by the defendant's rivals may, without limitation, be diminished if the conduct at issue tends to (i) increase barriers to entry or expansion by those rivals, (ii) cause rivals to lower their quality-adjusted output or raise their quality-adjusted price, or (iii) reduce rivals' incentives to compete against the defendant.

4) Liability is evaluated based on the combined effect of all anticompetitive conduct in which the defendant has engaged over the specified time period at issue. Even if no one element of conduct alone creates a meaningful risk of increasing the defendant's market power, the combined effect of all such conduct may do so.

5) In cases where the trading partners are customers, harm to them often comes in the form of higher prices, reduced output, lower quality products, or lessened innovation. In such cases, it is not necessary for the plaintiff to specify the precise nature of the harm that might be experienced in the future or to quantify with specificity any particular past harm. It is sufficient for the plaintiff to establish a significant weakening of the competitive constraints facing the defendant, from which such harms to direct or indirect customers can be presumed.

6) In cases where the trading partners are suppliers, harm to them often comes in the form of lower prices paid to them, reduced quantities purchased from them, or less favorable terms and conditions applied to their transactions. In cases where the trading partners are workers, harm to them often comes in the form of lower wages or less favorable conditions of employment. In such cases, it is not necessary for the plaintiff to specify the precise nature of the harm that might be experienced in the future or to quantify with specificity any particular past harm. It is sufficient for the plaintiff to establish a significant weakening of the competitive constraints facing the defendant, from which such harms to suppliers or workers can be presumed.

7) Plaintiffs need not show that the rivals whose ability to compete has been reduced are as efficient, or nearly as efficient, as the defendant. Harm to competition can arise when the competitive constraints on the defendant are weakened even when those competitive constraints come from less efficient rivals. Indeed, harm to competition can be especially great when a firm that faces limited competition further weakens its rivals.

8) Although the following circumstances may constitute evidence of a violation of this section, liability under section (a) does not require finding (i) that the unilateral conduct of the defendant altered or terminated a prior course of dealing between the defendant and a person subject to the exclusionary conduct; (ii) that the defendant treated persons subject to the exclusionary conduct differently than the defendant treated other persons; (iii) that any price of the defendant for a product or service was below any measure of the costs to the defendant for providing the product or service; (iv) that the conduct of the defendant makes no economic sense apart from its tendency to harm competition; (v) that the risk of harming competition presented by the conduct or any resulting actual harm must be quantified or proven with quantitative evidence; (vi) that when a defendant operates a multi-sided platform business, the conduct of the defendant presents harm to competition on more than one side of the multi-sided platform; (vii) that in a claim of predatory pricing, the defendant is likely to recoup the losses it sustains from below-cost pricing of the products or services at issue; or (viii) that the rival whose ability to compete has been reduced are as efficient, or nearly as efficient, as the defendant.

(g) Establishing that the defendant has engaged in anticompetitive exclusionary conduct does not require defining a "relevant market" in which that conduct takes place.

(h) A single firm may violate section (a) regardless of whether it has or may achieve a market share above a threshold recognized under Section 2 of the Sherman Act. Furthermore, this statute is does not require the plaintiff to establish any threshold of market power, as the focus of concern is on increases in market power.

(i) The burden is on the defendant to prove that any procompetitive justification for the challenged conduct is non-pretextual and does not weaken competitive discipline more than reasonably necessary to accomplish the procompetitive goal.

D. The California Unfair Practices Act

This section addresses the California Unfair Practices Act (UPA).

1. Exemptions

The Legislature may want to reconsider two existing exemptions from UPA challenges.

Section 17024 of the UPA expressly excludes from its coverage the services and products of companies considered to be "privately owned public utilities," the rates for which are subject to the jurisdiction of the California Public Utilities Commission (CPUC), even if the CPUC did not actually set rates. Uber successfully invoked this exemption in several cases where plaintiffs asserted that its ride-sharing services were being offered below-cost.[37] This exemption could be narrowed to apply only when the PUC actually regulates rates, not merely when the entity is subject to PUC jurisdiction.

2. Below-Cost Pricing

The Legislature should be aware that the requirement for a plaintiff in a UPA case to prove that the defendant had the "purpose" to destroy a competitor can be a difficult hurdle for the plaintiff to overcome, because the defendant can argue that its purpose was to lower prices for legitimate business reasons. The Legislature might consider altering this standard. However, the Legislature should recognize that removing this intent requirement from the UPA might stifle procompetitive price competition that benefits consumers. The goal of promoting competition would be undermined if the UPA were to protect less efficient firms from facing competition on the merits from their more efficient rivals.

We recognize that one of the original purposes of the UPA was to help small businesses and young firms in California to thrive. Protecting *all* market participants from exclusionary conduct by powerful firms, as discussed in this report, will especially help firms that are smaller, younger, or less well capitalized, as they are most vulnerable to such conduct. In addition, there are many other ways for the Legislature to assist small businesses and young firms in California to thrive, such as providing them with favorable tax treatment, preferential financing, or regulatory relief.

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[37] See *Uber Techs. Pricing Cases*, 46 Cal. App. 5th 963 (2020); *SC Innovations, Inc. v. Uber Techs. , Inc*. 434 F. Supp. 3d 782, 797-98 (N.D. Cal. 2020) (Uber immune from UPA claim for alleged below-cost pricing since its services were within CPUC jurisdiction); *Diva Limousines, Ltd. V. Uber Techs., Inc*.,392 F. Supp. 3d 1074 (N. D. Cal. 2019).