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# EXCLUSION AS A CORE COMPETITION CONCERN

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## ABSTRACT

A contemporary consensus in antitrust discourse inappropriately places exclusionary conduct at the periphery of competition policy. Contrary to that common view, exclusion is as important as collusion as a matter of precedent, the structure of doctrinal rules, economics, and sound competition policy. In particular, courts treat exclusionary violations as routine and serious competitive problems; an emerging doctrinal rule for truncated condemnation of “plain” exclusionary conduct (practices foreclosing rivals that lack a plausible efficiency justification) parallels the evolving judicial approach toward “naked” collusion; exclusion and collusion can be understood within a common economic framework that emphasizes the close relationship between the two ways of exercising market power, notwithstanding differences between them in the mechanisms by which market power is obtained; and policy concerns about the likelihood or significance of enforcement errors do not justify assigning exclusion a lesser priority than collusion. Moreover, anticompetitive exclusion may be the more important problem because it poses a particular threat to economic growth. Recognizing exclusion as a core concern of competition policy along with collusion could lead enforcers to place a higher priority on attacking exclusion, particularly conduct foreclosing potential entry in markets subject to rapid technological change, and to raise the penalties in egregious exclusion cases through criminal enforcement. It would also encourage further development of the doctrinal rule governing truncated condemnation of exclusionary conduct, and protect the legitimacy of the rules prohibiting anticompetitive exclusion against pressure for modifications that would limit enforcement.

## EXCLUSION AS A CORE COMPETITION CONCERN

*Jonathan B. Baker*\*

## INTRODUCTION

Exclusionary conduct<sup>1</sup> is commonly relegated to the periphery in contemporary antitrust discourse, while price-fixing, market division and other forms of collusion are placed at the core of competition policy. When the term “hard core” is applied to an antitrust violation,<sup>2</sup> or the “supreme evil” of antitrust is identified,<sup>3</sup> the reference is invariably to cartels.<sup>4</sup> At the same time, antitrust is “more cautious” in condemning exclusion than collusion.<sup>5</sup>

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\* Professor of Law, American University Washington College of Law. This paper revises and extends keynote remarks delivered to the Twenty-second Annual Workshop of the Competition Law and Policy Institute of New Zealand (CLPINZ). The author is especially grateful to Andy Gavil and also indebted to Svend Albaek, Rick Brunell, Peter, Carstensen, Pat DeGraba, Aaron Edlin, Harry First, Scott Hemphill, Heather Hughes, Al Klevorick, Prasad Krishnamurthy, Bob Lande, James May, Doug Melamed, Doug Richards, Steve Salop, David Snyder, Peter Taylor, John Woodbury, Josh Wright, an anonymous referee, and participants in the faculty business law workshop at American University, the law and economics workshop at Berkeley Law School, the CLPINZ workshop, and the Loyola Antitrust Colloquium. A revised version will be published in *Antitrust Law Journal*.

<sup>1</sup> The terms “exclusion” and “foreclosure,” which will be used interchangeably, encompass both the complete foreclosure of rivals or potential entrants and conduct that disadvantages rivals without necessarily inducing them to exit. Exclusion is anticompetitive if the excluding firms use it to obtain or maintain market power, as by raising price or keeping a supracompetitive price from declining.

<sup>2</sup> *E.g.*, OECD, 1998 Recommendation of the Council Concerning Effective Action Against Hard Core Cartels (March 25, 1998) reprinted at <http://www.oecd.org/dataoecd/39/63/2752129.pdf> (p. 58) (“[H]ard core cartels are the most egregious violations of competition law . . . .”). “Hard core cartels” are collusive arrangements lacking an efficiency justification. In Europe, the term “hard core” is also applied to a class of prohibited vertical restraints. Commission Regulation (EC) 330/2010, 2010 O.J. (L 102) 1, 5 (block exemption for vertical agreements not applied to supply or distribution agreements containing a “hardcore” restriction such as vertical price-fixing or territorial or customer sales restrictions).

<sup>3</sup> *Verizon Commc’ns Inc. v. Trinko*, 540 U.S. 398, 408 (2004) (collusion is the “supreme evil” of antitrust).

<sup>4</sup> *Accord*, U.S. Dept. of Justice, Antitrust Enforcement and the Consumer 3, retrieved Aug. 31, 2011, available at [http://www.justice.gov/atr/public/div\\_stats/211491.htm](http://www.justice.gov/atr/public/div_stats/211491.htm) (cartels are “the worst” antitrust offenses).

<sup>5</sup> *See* HERBERT HOVENKAMP, ANTITRUST ENTERPRISE 24 (2005). *Cf.* *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984) (“Concerted activity subject to §1 is judged more sternly than unilateral activity under §2.”); *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 888 (2007) (“Our recent cases formulate

Antitrust commentators associated with the Chicago school<sup>6</sup> have long expressed deep skepticism about exclusion as an antitrust theory, particularly as applied to dominant firm conduct.<sup>7</sup> Mainstream and progressive commentators also call collusion the central antitrust problem,<sup>8</sup> although post-Chicago commentators tend to take exclusionary conduct more seriously than most.<sup>9</sup> Moreover, the antitrust enforcement agencies routinely emphasize collusion over exclusion in articulating their enforcement priorities.<sup>10</sup> These rhetorical distinctions may be framed in

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antitrust principles in accordance with the appreciated differences in economic effect between vertical and horizontal agreements.”).

<sup>6</sup> The three major eras of antitrust interpretation – classical (1890 to the 1940s, structural (1940s through the 1970s), and Chicago school (since the late 1970s) – and emerging post-Chicago approaches are surveyed in Jonathan B. Baker, *A Preface to Post-Chicago Antitrust*, in *POST-CHICAGO DEVELOPMENTS IN ANTITRUST ANALYSIS* 60 (Roger van den Bergh, Roberto Pardolesi & Antonio Cucinotta, eds. 2002).

<sup>7</sup> In Judge Robert Bork’s view, in his influential book *The Antitrust Paradox*, courts should almost never credit the possibility that a firm could exclude rivals by refusing to deal with suppliers or distributors also or otherwise force rivals to bear higher distribution costs. ROBERT H. BORK, *THE ANTITRUST PARADOX* 156, 346 (1978). However, Bork did identify one case in which he believed that unilateral conduct by a dominant firm had properly been condemned as exclusionary. *Id.* at 344–46 (citing *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951)). Judge Richard Posner has similarly described anticompetitive exclusion as “rare,” RICHARD POSNER, *ANTITRUST LAW* 194 (2d ed. 2001), though he is not as skeptical about exclusion as other Chicago school commentators. *Id.* at 194 & note 2.

<sup>8</sup> For example, Professor Herbert Hovenkamp, author of the leading antitrust treatise, recently described price-fixing as “kind of the first-degree murder of antitrust violations,” Thomas Catan, *Critics of E-Books Lawsuit Miss the Mark, Experts Say*, WALL ST. J., Apr. 23, 2012, at B1, and Professor Robert Lande, a Director of the pro-enforcement American Antitrust Institute, recently called collusion among rivals “the essence of the most evil thing we have in antitrust.” Sara Forden, *What’s Apple’s Best Defense in E-Books Antitrust Case?*, WASH. POST, Apr. 17, 2012.

<sup>9</sup> Professor Steven Salop, a leading post-Chicago antitrust commentator, has long emphasized the importance of antitrust’s concern with exclusion. Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price*, 96 YALE L.J. 209, 213 (1986); Steven C. Salop, *Economic Analysis of Exclusionary Vertical Conduct: Where Chicago Has Overshot the Mark*, in *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST* 141, 142 (Robert Pitofsky, ed. 2008). See generally Jonathan B. Baker, Remarks on the Presentation of the American Antitrust Institute Antitrust Achievement Award to Steven C. Salop (June 24, 2010), [http://www.antitrustinstitute.org/~antitrust/sites/default/files/Baker%20Salop%20Comments\\_062820101005.pdf](http://www.antitrustinstitute.org/~antitrust/sites/default/files/Baker%20Salop%20Comments_062820101005.pdf). Exclusionary conduct has been the source of the most significant divide between Chicago school and post-Chicago commentators.

<sup>10</sup> A recent Assistant Attorney General for Antitrust identified cartel enforcement as his agency’s “top priority,” well ahead of “single firm conduct” (which often involves exclusion by a dominant firm). Thomas O. Barnett, Assistant Att’y Gen. for Antitrust, U.S. Dep’t of Justice, *Antitrust Enforcement Priorities: A Year in Review* (Nov. 19, 2004),

terms of traditional doctrinal distinctions between concerted and unilateral conduct, and between horizontal and vertical conduct, but, as section I of this article explains, they are better understood in terms of the related but not identical economic distinction between collusive and exclusionary conduct.

Exclusion is routinely described as having a lesser priority than collusion even though exclusion is well established as a serious competitive problem in both antitrust law and industrial organization economics. Section II of this article shows that exclusion has not been downplayed in court decisions, and that the emerging doctrinal rules governing exclusion and collusion place the two types of competitive problems on similar footing. In formal structure, antitrust rules are not tougher on collusion. Rather, the rules are tough on conduct with no plausible efficiency justification: what is commonly termed “naked” collusion or what will be referred to here as “plain” exclusion. Section III demonstrates that collusion and exclusion are also closely related as a matter of economics – so much so as to make the economic reasons for concern about anticompetitive collusion equally reasons for concern about anticompetitive exclusion. If anything, this section further explains, anticompetitive exclusion may be the more important problem because of the particular threat exclusion poses to economic growth.

Notwithstanding the broad parallels in the economic analysis of exclusion and collusion, the two types of anticompetitive conduct arise through different economic mechanisms. Just as colluding firms must find a way to solve “cartel problems” (reaching consensus on terms of coordination, deterring cheating on those terms, and preventing new competition), excluding firms must find a way to solve “exclusion problems” (identifying an exclusionary method, excluding sufficient rivals to harm competition, and ensuring that the exclusionary conduct is

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*available at* <http://www.justice.gov/atr/public/speeches/206455.htm>. Similarly, it is “uncontroversial,” according to a former Chairman of the Federal Trade Commission, that non-merger antitrust enforcement should focus on “horizontal activities” (which are often collusive). Timothy J. Muris, Chairman, Fed. Trade Comm’n, Antitrust Enforcement at the Federal Trade Commission: In a Word—Continuity (Aug. 7, 2001), *available at* <http://www.ftc.gov/speeches/muris/murisaba.shtm>. By “horizontal activities,” Muris intended to refer primarily to collusive conduct; he would have used the term “single firm” to discuss most exclusionary behavior. E-mail from Timothy Muris to Jonathan Baker (Dec. 10, 2011, 7:37 PM EST) (on file with author). Even enforcers “not so aligned with the Chicago School may approach exclusionary claims more cautiously than collusion claims.” John Woodbury, *Paper Trail: Working Papers and Recent Scholarship*, ANTITRUST SOURCE, Apr. 2012, *available at* [http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/apr12\\_papertrail\\_4\\_26f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/apr12_papertrail_4_26f.authcheckdam.pdf) (referencing Justice Department materials from the current administration) (comment on working paper predecessor to this article).

profitable for each excluding firm). Despite these differences, as section IV demonstrates, the doctrinal rules identified in section II truncate the comprehensive reasonableness analysis of exclusionary conduct in ways analogous to the structured reasonableness rules governing collusive conduct – in both cases obviating the need to demonstrate the specific mechanism defendants would or did employ, and so making it unnecessary to show how or whether defendants solve the relevant exclusion problems or cartel problems. Again, therefore, the formal structure of antitrust rules does not downplay anticompetitive exclusion.

The rhetorical consensus is so powerful that claims of priority for collusion over exclusion are typically stated without explicit justification. They nevertheless appear to be grounded primarily in two commonly-accepted and closely-related suppositions,<sup>11</sup> evaluated critically in section V along with other purported justifications for downplaying exclusion. The first supposition is that it is more difficult for courts and enforcers to identify anticompetitive exclusionary conduct than to identify harmful collusive conduct, because conduct that looks exclusionary commonly also promotes competition by enhancing efficiency. The second is that exclusionary conduct often benefits consumers in the short run, and that in consequence, overly aggressive enforcement against exclusionary conduct risks chilling pro-competitive practices such as price-cutting and new product introductions. Together, these premises, if accepted, would imply that mistakes in enforcement and adjudication against anticompetitive exclusion pose greater threats than mistakes in enforcement and adjudication against anticompetitive collusion, and, in consequence, would justify downplaying exclusionary conduct in antitrust enforcement.

Justice Scalia's opinion for the Supreme Court in *Verizon Communications Inc. v. Trinko*<sup>12</sup> also suggests that mistakes in enforcement and adjudication are more frequent and more troublesome in exclusion cases, but grounds that view in different and more controversial arguments.

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<sup>11</sup> *E.g.*, U.S. DEP'T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 12-13 (2008), *available at* <http://www.justice.gov/atr/public/reports/236681.pdf>, *withdrawn*, [http://www.usdoj.gov/atr/public/press\\_releases/2009/245710.htm](http://www.usdoj.gov/atr/public/press_releases/2009/245710.htm). These themes were also emphasized at a conference discussion of a draft of this article, including among those sympathetic to a robust antitrust concern with exclusionary conduct.

<sup>12</sup> *Verizon Commc'ns Inc. v. Trinko*, 540 U.S. 398 (2004). The central claim in the case involved exclusionary conduct: a class of local telephone service customers alleged that Verizon, an incumbent local exchange carrier, had protected its monopoly prices from erosion by denying interconnection services to entrants seeking to offer competing local telephone service. (Verizon was obligated to provide new entrants with interconnection services under the Telecommunications Act of 1996.) The Court held that Verizon's unilateral refusal to assist its rivals did not state a claim under the Sherman Act.

The opinion's sweeping rhetoric – all dicta<sup>13</sup> – minimizes the competitive concern arising from a monopolist's unilateral exclusionary acts by implicitly describing the consequences of judicial mistakes from Sherman Act §2 enforcement in asymmetric terms.<sup>14</sup> The *Trinko* opinion can be understood to claim that false negatives (false acquittals) are not troublesome because monopolies are temporary, hence self-correcting, and that false positives (false convictions) are troublesome because monopolies foster economic growth<sup>15</sup> and because of the difficulty of crafting relief to avoid ongoing judicial supervision, at least with respect to the violation alleged in the case.<sup>16</sup> Consistent with its skeptical view of antitrust enforcement against exclusionary conduct, *Trinko* declares that collusion is the “supreme evil” of antitrust<sup>17</sup> and rhetorically cabins-in an earlier pro-plaintiff monopolization decision, *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*,<sup>18</sup> by describing it as “at or near the outer boundary of Section 2 liability.”<sup>19</sup>

Whether the claimed policy justifications for downplaying exclusion

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<sup>13</sup> *Trinko* is best read as precluding monopolization liability in a setting in which a separate statutory scheme provided for extensive regulation aimed at promoting competition. (The statute incorporated specific mechanisms for promoting competition by requiring incumbent monopolists to deal with entrants.) If the regulatory scheme is sufficiently extensive and effective, *Trinko* holds, antitrust enforcement may be displaced. See *Verizon Commc'ns Inc. v. Trinko*, 540 U.S. 398, 413 (2004) (“the [regulatory] regime was an effective steward of the antitrust function”). See also *Nobody v. Clear Channel Communications, Inc.*, 311 F. Supp. 2d 1048, 1112–14 (D. Colo. 2004) (limiting *Trinko* to regulated industry settings); but see *John Doe 1 v. Abbott Laboratories*, 571 F.3d 930 (9th Cir. 2009) (applying *Trinko* outside the regulated industries context). Since *Trinko*, the Court has maintained its skepticism about the value of antitrust enforcement, and its resulting preference for having competition issues decided exclusively by an industry regulator rather than preserving concurrent jurisdiction in an antitrust court. *Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264 (2007) (expanding the implied antitrust immunity conferred by regulation under the securities laws). See generally Howard A. Shelanski, *The Case for Rebalancing Antitrust and Regulation*, 109 MICH. L. REV. 683 (2011).

<sup>14</sup> Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 ANTITRUST L.J. 3, 42-51 (2004) (offering a detailed exposition and critique of the rhetoric of the majority opinion in *Trinko*).

<sup>15</sup> The opinion argues in particular that the prospect of monopoly induces risk-taking and innovation. *Verizon Commc'ns Inc. v. Trinko*, 540 U.S. 398, 406 (2004).

<sup>16</sup> *Verizon Commc'ns Inc. v. Trinko*, 540 U.S. 398, 407-08, 414-15 (2004).

<sup>17</sup> *Verizon Commc'ns Inc. v. Trinko*, 540 U.S. 398, 408 (2004).

<sup>18</sup> *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1983).

<sup>19</sup> *Verizon Commc'ns Inc. v. Trinko*, 540 U.S. 398, 409 (2004). *Accord*, *Pacific Bell Tel. Co. v. linkLine Commc'ns, Inc.*, 555 U.S. 438, 448 (2009) (*Aspen* suggests that a firm's unilateral refusal to deal with its rivals can give rise to antitrust liability in “limited circumstances”) (dictum). Appeals courts have noted the narrow reading that *Trinko* and *linkLine* give *Aspen*. *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 316 (3d Cir. 2007); *MetroNet Services Corp. v. Qwest Corp.*, 383 F.3d 1124, 1131–34 (9th Cir. 2004).

are grounded in common ideas about the difficulty distinguishing procompetitive conduct from anticompetitive exclusion or in the more controversial arguments made in *Trinko*, they do not stand up to analysis. The antitrust enforcement agencies do challenge collusion more frequently than exclusion. This observation could be explained through a theory sympathetic to assigning exclusion a lower priority than collusion, as consistent with the dual suppositions that it is more difficult to rule out efficiencies and avoid erroneous findings of liability in exclusionary conduct cases than in collusive conduct cases. But, as section V explains, there are better interpretations for the relatively low frequency of enforcement against anticompetitive exclusion. Section V also criticizes other policy arguments that have been offered for assigning lesser priority to exclusion, including one based on empirical studies, another rooted in an analysis of institutional competence, and still others suggested by the Supreme Court in *Trinko*.

The troublesome rhetorical consensus placing exclusionary conduct at antitrust's periphery, not its core, is not just unwarranted; it is pernicious. The more that exclusion is downplayed rhetorically, the more that its legitimacy as a subject for antitrust enforcement will be undermined,<sup>20</sup> so the greater the likelihood that antitrust rules will eventually change to limit enforcement against anticompetitive foreclosure when they should not. Accordingly, anticompetitive exclusion, like anticompetitive collusion, must be understood as a core concern of competition policy.

Section VI of this article discusses the implications for antitrust enforcement of recognizing exclusion as a core concern of competition policy along with collusion. Doing so could lead enforcers to assign a higher priority to attacking exclusion than they do today, particularly conduct foreclosing potential entry in markets subject to rapid technological change, though the relative frequency of exclusion cases is unlikely to increase greatly as a result. It could also encourage enforcers to seek criminal penalties in egregious exclusion cases. In addition, it would encourage further development of the doctrinal rule governing truncated condemnation of exclusionary conduct in the courts, and protect the rules governing anticompetitive exclusion against pressure for modifications that would limit enforcement.

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<sup>20</sup> Cf. Jonathan B. Baker, *Preserving a Political Bargain: The Political Economy of the Non-Interventionist Challenge to Monopolization Enforcement*, 76 ANTITRUST L.J. 605, 625-25 (2010) ("Had *Microsoft* come out differently, *Trinko* might have gone farther to question the legitimacy of the antitrust bar on monopolization.").



## I. EXCLUSION AS AN ANTITRUST CATEGORY

Exclusion and collusion are neither statutory nor doctrinal categories; they are economic categories. The Sherman Act distinguishes between concerted conduct (§1) and single firm behavior (§2),<sup>21</sup> each of which could harm competition through exclusion or collusion.<sup>22</sup> The doctrinal rules developed to implement both the Sherman Act and the Clayton Act prohibition on anticompetitive mergers distinguish between horizontal and vertical agreements, each of which again could harm competition through exclusion or collusion.<sup>23</sup> Although these legal categories continue to play a role in modern antitrust analysis, “today’s antitrust lawyers, enforcers and courts focus far more on the nature of the anticompetitive effects, and in private cases, the antitrust injuries, alleged.”<sup>24</sup> For this reason, the antitrust casebook I co-authored “separately groups conduct threatening collusive anticompetitive effects – including traditional horizontal agreements,

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<sup>21</sup> Sherman Act §2 also recognizes conspiracy to monopolize, but this statutory provision is rarely invoked.

<sup>22</sup> A single firm could harm competition collusively if a dominant firm fixes prices or divides markets in cooperation with a fringe rival, for example.

<sup>23</sup> The Sherman Act also distinguishes between exclusionary and exploitative conduct. See *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966) (the exercise of market power by a firm that obtained it “as a consequence of a superior product, business acumen, or historic accident” is not actionable as monopolization). *But cf. Einer Elhauge, Tying, Bundled Discounts, and the Death of the Single Monopoly Theory*, 123 HARV. L. REV. 397, 420-26 (2009) (arguing that the Supreme Court’s tying jurisprudence is predicated in part on recognition of the exploitation of monopoly power as a basis for liability). By contrast, under the European approach to competition policy, a dominant firm can be found to have abused its position through exploitative offenses such as charging higher prices, though such cases are rare, and it is an open question whether exploitative conduct could be reached as a violation of FTC Act §5. Compare *E.I. Du Pont de Nemours & Co. v. Fed. Trade Comm’n*, 729 F.2d 128, 139 (2d Cir. 1984) (*Ethyl*) (requiring “some indicia of oppressiveness” such as anticompetitive intent or the absence of a legitimate business justification before labeling unilateral facilitating practices as “unfair” under the FTC Act) with Jonathan B. Baker, *Two Sherman Act Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 38 ANTITRUST BULL. 143, 211-12 (1993) (“the Supreme Court has repeatedly indicated that the FTC may condemn a unilateral act under FTC Act § 5 when an agreement to engage in the identical conduct would violate Sherman Act § 1”).

<sup>24</sup> ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY vii (2d ed. 2008) (Preface to the First Edition). Although the modern focus emphasizes effects, the Sherman Act’s agreement requirement means that the statute does not reach every instance in which firms harm competition through coordination, Jonathan B. Baker, *Two Sherman Act Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 38 ANTITRUST BULL. 143 (1993), and, as indicated in the previous note, the anticompetitive conduct requirement in the case law means that the statute does not reach every instance in which firms harm competition through exclusion.

vertical intrabrand agreements and horizontal mergers – and conduct threatening exclusionary effects -- including dominant firm behavior, vertical interbrand restraints and vertical mergers.”<sup>25</sup> In making this distinction, the casebook adopted the major structural division employed by Judge Posner in his antitrust treatise and his co-authored antitrust casebook.<sup>26</sup>

Although exclusionary claims are most commonly framed as challenges to vertical agreements or monopolization, antitrust’s traditional doctrinal categories do not perfectly track the distinction between exclusion and collusion. Vertical conduct is not invariably exclusionary. Agreements between manufacturers and distributors, for example, may harm competition by facilitating collusion at either level as well as by excluding entrants into manufacturing or distribution.<sup>27</sup> Nor is horizontal conduct invariably collusive. The category includes, for example, exclusionary group boycotts.<sup>28</sup> Moreover, dominant firms could harm competition by colluding with fringe rivals as well as by excluding those firms.

The antitrust rules most closely associated with exclusion – those governing the conduct of monopolists and would-be monopolists and vertical agreements – have long been among the most controversial in U.S. competition policy; the antitrust norms in these categories have aptly been described as “contested.”<sup>29</sup> Over the course of antitrust history, the Supreme Court has repeatedly altered its approach to evaluating the legality of vertical non-price restraints.<sup>30</sup> The modern legal rule nearly inverts the

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<sup>25</sup> *Id.* The doctrinal categories are grouped based on whether the harm to competition addressed in the leading cases more commonly results from exclusion or collusion, but all the practices could harm competition either way.

<sup>26</sup> RICHARD A. POSNER, *ANTITRUST LAW* (2d ed. 2001); RICHARD A. POSNER & FRANK H. EASTERBROOK, *ANTITRUST: CASES, ECONOMIC NOTES AND OTHER MATERIALS* xv (2d ed. 1981). *Cf.* ROBERT H. BORK, *THE ANTITRUST PARADOX* 134 (1978) (describing collusive and exclusionary conduct as “two theories of the ways in which competition may be injured that ... shape and drive the law”).

<sup>27</sup> *E.g.*, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 892–94 (2007) (discussing both collusive and exclusionary explanations for resale price maintenance).

<sup>28</sup> *E.g.*, *Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co.*, 472 U.S. 284 (1985).

<sup>29</sup> William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 *ANTITRUST L.J.* 377, 410 (2003) (describing as “contested” the antitrust norms governing “abuse of dominance and vertical contractual restraints” between 1961 and 2000). Kovacic sees different patterns in the evolution of norms developed in other areas of antitrust: “progressive contraction (Robinson-Patman matters), progressive expansion (criminal and civil horizontal restraints), [or] contraction followed by stabilization (mergers).” *Id.*

<sup>30</sup> Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 *U. CHI. L. REV.* 6, 6 (1981) (between 1963 and 1977, the

rule applied forty-five years ago.<sup>31</sup> The standard used to test vertical agreements concerning price has been even less consistent,<sup>32</sup> and remains contested,<sup>33</sup> although the case law did not explicitly associate resale price maintenance with exclusion until recently.<sup>34</sup> A switch of one vote would have led the Supreme Court to abandon the longstanding per se prohibition against tying.<sup>35</sup> Monopolization standards are also controversial, as is evident from a debate between the federal antitrust enforcement agencies early in the 21<sup>st</sup> century.<sup>36</sup>

From a contemporary perspective that recognizes the central role economic concepts play in antitrust today, the controversies over

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legality of (non-price) distribution restrictions “oscillated from the Rule of Reason to per se illegality and back”).

<sup>31</sup> The Court adopted a rule of per se illegality in 1967, *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), but overruled that decision in favor of applying the rule of reason ten years later. *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). Since 1977, vertical non-price restraints have rarely been prohibited, leading one commentator to describe the practical standard as close to per se legality. Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 ANTITRUST L.J. 67 (1991).

<sup>32</sup> Since vertical restraints on price were held illegal per se in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), Congress authorized states to allow such agreements, Miller-Tydings Act, Pub. L. No. 314, ch. 690, Title III, 50 Stat. 693 (1937), broadened that authority, McGuire Act, ch. 745, 66 Stat. 632 (1952) and returned the law to the rule of per se illegality by repealing that authorization, Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801. More recently, the Supreme Court overruled *Dr. Miles* and adopted the rule of reason. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

<sup>33</sup> The *Leegin* decision drew a passionate dissent from four Justices. *Id.* at 908 (Breyer, J., dissenting). One month before the oral argument, an FTC Commissioner issued an unusual public statement detailing her disagreement with the Solicitor General’s pro-defendant brief. Pamela Jones Harbour, Commissioner, Fed’l Trade Comm’n, An Open Letter to the Supreme Court of the United States (Feb. 26, 2007), available at <http://www.ftc.gov/speeches/harbour/070226verticalminimumpricefixing.pdf>. The continuing controversy over resale price maintenance in the wake of *Leegin* is discussed in Andrew I. Gavil, *Resale Price Maintenance in a Post-Leegin World: A Comparative Look at Recent Developments in the United States and European Union*, THE CPI ANTITRUST JOURNAL, June 2010 (1), available at, <https://www.competitionpolicyinternational.com/jun-10-1>.

<sup>34</sup> *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 892–94 (2007) (discussing both collusive and exclusionary explanations for resale price maintenance).

<sup>35</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) (5-4 decision).

<sup>36</sup> During the George W. Bush administration the Justice Department encouraged courts to adopt a doctrinal approach that would favor defendants but the Federal Trade Commission pointedly refused to go along. At the start of the Obama administration, the Justice Department withdrew the previous administration’s proposal. See Jonathan B. Baker, *Preserving a Political Bargain: The Political Economy of the Non-Interventionist Challenge to Monopolization Enforcement*, 76 ANTITRUST L.J. 605, 606–07 (2010).

monopolization and vertical restraints standards are best understood as proxy battles over the appropriate treatment of exclusionary conduct.<sup>37</sup> While the rhetorical consensus prioritizing collusion could be interpreted from a statutory perspective as downplaying single firm conduct and from a doctrinal perspective as downplaying vertical agreements and monopolization, this article interprets it from an economic perspective that frames contemporary antitrust thinking as downplaying exclusionary conduct.

## II. EXCLUSION IN ANTITRUST CASE LAW AND DOCTRINE

The rhetorical consensus downplaying the significance of exclusionary conduct is surprising because anticompetitive exclusion is treated by antitrust law as a routine and serious competitive problem. Many leading U.S. antitrust decisions, including recent ones, have been concerned primarily with exclusionary conduct. Microsoft made it difficult for Netscape to market its browsers to computer users in order to protect its Windows operating system monopoly from the competition that would be created if software applications could access any operating system through the browser.<sup>38</sup> Standard Oil exploited its leverage over the railroads to stop the entry of new refiners in order to protect its monopoly in oil refining.<sup>39</sup> Before AT&T (Bell System) was broken up, it maintained market power in unregulated markets for specialized telephone service and customer premises equipment by discriminating against rivals that sought to connect with its regulated local telephone service monopoly.<sup>40</sup> Visa and MasterCard prevented member banks from issuing American Express and Discover

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<sup>37</sup> Cf. RICHARD A. POSNER, *ANTITRUST LAW* 4 (2d ed. 2001) (arguing that the economic theory of monopoly had much more to say about collusive practices than exclusionary ones, leading some economists and lawyers identified with the Chicago school (but not Posner) to the view “that there was no economic basis for concern” with ... exclusionary practices”). *But cf.* *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 747–48 (1988) (dissent explains the Court’s decision as turning, without justification, on treating the distinction between horizontal and vertical agreements as more important than the distinction between collusive and exclusionary conduct).

<sup>38</sup> *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (en banc).

<sup>39</sup> *United States v. Standard Oil*, 221 U.S. 1 (1911). *See generally* Elizabeth Granitz & Benjamin Klein, *Monopolization by Raising Rivals Costs: The Standard Oil Case*, 39 *J.L. & ECON.* 1 (1996). *Compare* George L. Priest, *Rethinking the Economic Basis of the Standard Oil Refining Monopoly: Dominance Against Competing Cartels*, 85 *S. CAL. L. REV.* 605 (2012) (questioning some of Granitz & Klein’s argument) *with* Benjamin Klein, *The Hub-and-Spoke Conspiracy that Created the Standard Oil Monopoly*, 85 *S. CAL. L. REV.* 459 (2012) (responding to Priest).

<sup>40</sup> *See United States v. Am. Tel. & Tel.*, 552 F. Supp. 131, 162 (D.D.C. 1982) (entering consent decree requiring divestitures).

cards in order to protect their own market power.<sup>41</sup>

Exclusionary conduct allegations are also central to other antitrust decisions commonly thought of as alleging collusion. The NCAA threatened two large state universities with disciplinary action if they did not comply with the NCAA's arrangement for broadcasting college football games.<sup>42</sup> Dentists that did not comply with the advertising restrictions promulgated by the California Dental Association could be censured or expelled.<sup>43</sup> The National Society of Professional Engineers encouraged state societies to launch disciplinary proceedings against engineers that did not comply with its ethical code, which included the challenged restrictions on competitive bidding restrictions.<sup>44</sup> The predatory conspiracies alleged (but ultimately not demonstrated) in *Brooke Group* and *Matsushita* were said to have excluded generic cigarettes and a U.S. firm manufacturing televisions, respectively.<sup>45</sup> The horizontal (collusive) market division agreement attacked in *Topco* allowed the firms to prevent their rivals from selling the cooperative's private label products.<sup>46</sup> The nearly two hundred insurance companies indicted for price-fixing during the early 1940s were also accused of employing boycotts, coercion, and intimidation to prevent competition from firms that were not members of their trade association.<sup>47</sup>

During the modern era, moreover, the Supreme Court and the appeals courts have addressed exclusionary conduct without consistently favoring either defendants or plaintiffs.<sup>48</sup> Looking to outcome, reasoning and tone, decisions of the appeals courts during the first half of 2011 (an

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<sup>41</sup> United States v. Visa, 344 F.3d 229 (2d Cir. 2003).

<sup>42</sup> NCAA v. Bd. of Regents of the Univ. of Okla., 468 U.S. 85 (1984).

<sup>43</sup> Cal. Dental Ass'n v. Fed. Trade Comm'n, 526 U.S. 756 (1959).

<sup>44</sup> United States v. Nat'l Soc'y of Prof'l Eng'rs, 389 F. Supp. 1193, 1210 (D.D.C. 1974), *aff'd* 555 F.2d 978 (D.C. Cir. 1977), *aff'd* 435 U.S. 679 (1978).

<sup>45</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). *Brooke Group* was arguably decided incorrectly. See Jonathan B. Baker, *Predatory Pricing after Brooke Group: An Economic Perspective*, 62 ANTITRUST L.J. 585, 598 (1994) ("the Court took the case from the jury to award judgment to the defendant when the record on this key question of fact, construed favorably to plaintiff, arguably supported plaintiff's position").

<sup>46</sup> United States v. Topco Associates, Inc. (405 U.S. 596 (1972)). See generally Peter C. Carstensen & Harry First, *Rambling Through Economic Theory: Topco's Closer Look*, in ANTITRUST STORIES 171 (Eleanor M. Fox & Daniel A. Crane, eds., 2007).

<sup>47</sup> United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944).

<sup>48</sup> The relative success of plaintiffs and defendants is difficult to interpret because it may depend on a variety of factors beyond the general attitude of the courts, including whether legal rules are changing, the willingness of firms to engage in questionable conduct that could be challenged, and the willingness of the parties to a lawsuit to litigate rather than settle. Accordingly, even a consistently one-sided pattern of decisions may be a poor indicator of judicial attitudes toward exclusionary conduct.

arbitrarily chosen recent period),<sup>49</sup> as well as notable decisions of the circuit courts and the Supreme Court from the past three decades,<sup>50</sup> do not systematically favor either side.

To show how seriously the courts take exclusionary conduct, this article adopts two approaches. Section II.A documents the wide range of exclusionary conduct that the courts have evaluated. This informal survey shows that anticompetitive exclusion has not been downplayed by the courts through limitation to a narrow range of practices.

Section II.B identifies parallels in the formal structure of the emerging doctrinal rules employed by the courts to identify anticompetitive exclusionary and anticompetitive collusive conduct. In particular, the courts have evolved a similar approach to the two doctrinal areas: adopting a presumption in each against conduct lacking a plausible efficiency justification. Although antitrust enforcers more frequently allege that the challenged conduct has no justification in collusion cases than exclusion cases, the parallel structure of the relevant legal rules shows that the rules themselves are not tougher on collusive conduct than on exclusionary practices.

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<sup>49</sup> During this period, arguably pro-enforcement exclusion decisions were issued by circuit courts in *Watson Carpet & Floor Covering, Inc. v. Mohawk Indus., Inc.*, 648 F.3d 452 (6th Cir. 2011), *E.I DuPont de Nemours & Co. v. Kolon Indus., Inc.*, 637 F.3d 435 (4th Cir. 2011), and *Realcomp II, Ltd. v. FTC.*, 635 F.3d 815 (6th Cir. 2011), while arguably non-interventionist exclusion decisions were issued in *Se. Mo. Hosp. v. C.R. Bard Inc.*, 642 F.3d 608 (8th Cir. 2011), *Brantley v. NBC Universal, Inc.*, 2011 WL 2163961 (9th Cir. 2011), and *Smugglers' Notch Homeowners Ass'n v. Smugglers' Notch Mgmt. Co.*, 414 Fed. Appx. 372 (2d Cir. 2011).

<sup>50</sup> The Supreme Court exclusion decisions listed below more often take the non-interventionist side, exclusively so since 1993, but the circuit courts do not appear to have interpreted the recent pattern as a mandate to raise the bar to plaintiffs in exclusion cases. Notable decisions from the Supreme Court and appeals courts arguably on the pro-enforcement side of the ledger include *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451 (1992); *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1983); *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917 (6th Cir. 2005); *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181 (3d Cir. 2005); *United States v. Visa*, 344 F.3d 229 (2d Cir. 2003); *LePage's Inc. v. 3M*, 324 F.2d 141 (3d Cir. 2003); *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (en banc); and *JTC Petroleum Co. v. Piasa Motor Fuels, Inc.*, 190 F.3d 775 (7th Cir. 1999). Notable decisions arguably on the non-interventionist side include *Pac. Bell Tel. Co. v. LinkLine Commc'ns, Inc.*, 555 U.S. 438 (2009); *Verizon Commc'ns Inc. v. Trinko*, 540 U.S. 398, 408 (2004); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1993); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984); *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008); *E&L Consulting, Ltd. v. Doman Indus. Ltd.*, 472 F.3d 23 (2d Cir. 2006); *United States v. AMR Corp.*, 335 F.3d 1109 (10th Cir. 2003); and *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157 (9th Cir. 1997).

### A. Exclusionary Practices Identified by the Courts

The courts do not treat exclusion as an exceptional practice; instead they have recognized that exclusionary conduct harming competition can take a wide range of forms.<sup>51</sup> The anticompetitive possibilities surveyed have been divided into three broad categories based on the mechanism by which exclusion takes place, with an eye toward the economic analysis in section III. In general, these practices are neither necessarily nor invariably anticompetitive, as rivals can be excluded without harm to competition, and practices that exclude rivals could help firms lower costs, improve products, or otherwise achieve efficiencies as well as helping them obtain or maintain market power. The survey is not intended as an inventory of all possible means of exclusion; rather, it is intended to illustrate the breadth of conduct that could harm competition through foreclosure.

The practices described in the first two categories exclude rivals by imposing a constraint on the latter firms' conduct, as by raising rivals' costs or, to similar effect, reducing rivals' access to customers.<sup>52</sup> The methods in the first category can be accomplished by the excluding firms alone, whether through the unilateral action of a single excluding firm or the joint action of a group of excluding firms. The methods in the second category require the excluding firms to coordinate with firms that are not rivals through the purchase of an exclusionary right. Because coordination is required, the profitability of practices in the second category turns in part on factors not relevant to the profitability of practices in the other categories, as discussed below in section IV.A. In the third category, the excluding firms discourage competition by altering their rivals' incentives, in particular by credibly threatening the rivals with harm should the latter firms seek to compete aggressively.

*Constraints Imposed on Rival Conduct.* The most obvious anticompetitive exclusionary strategies directly constrain rivals by imposing costs or reducing rivals' access to customers. A dominant firm might destroy a fringe rival's distribution facilities,<sup>53</sup> or obtain a monopoly

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<sup>51</sup> See generally Richard M. Steuer, *Foreclosure*, in 2 ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY 926–29 (2008) (surveying case law).

<sup>52</sup> Input foreclosure strategies are commonly thought of as raising rivals' costs while customer foreclosure strategies are commonly thought of as limiting rivals' access to the market, but customer foreclosure strategies can also be understood as another form of raising rivals' costs on the view that they raise rivals' costs of distribution.

<sup>53</sup> *Conwood v. United States Tobacco*, 290 F.3d 768 (6<sup>th</sup> Cir. 2002) (dominant manufacturer of snuff excluded a fringe rival by destroying its rival's in-store display racks). See Kenneth P. Brevoort & Howard P. Marvel, *Successful Monopolization Through Predation: The National Cash Register Company*, 21 RES. IN L. & ECON. 85 (2004)

position through fraudulent acquisition of a patent.<sup>54</sup> To similar effect, a vertically-integrated dominant firm could redesign its upstream product in order to create an incompatibility for its downstream rival.<sup>55</sup> A firm may also directly exclude its rivals by failing to disclose in advance its patent rights in a technology adopted as an industry standard,<sup>56</sup> engaging in sham litigation,<sup>57</sup> or manipulating a regulatory scheme.<sup>58</sup>

Other methods by which firms can impose constraints that exclude

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(dominant firm maintained its monopoly power in part through espionage and sabotage; federal criminal prosecution settled by consent). Allegedly tortious conduct accompanied a restriction on access to supply in *Watson Carpet & Floor Covering, Inc. v. Mohawk Indus., Inc.*, 648 F.3d 452 (6th Cir. 2011) (“false derogatory accusations” about the excluded firm to potential customers). *See also* *Nat’l Ass’n of Pharm. Mfrs. V. Ayerst Lab.*, 850 F.2d 904, 916 (2d Cir. 1988) (dominant firm’s public statements disparaging rival’s product would support monopolization claim if “clearly false, clearly material, and clearly likely to induce reasonable reliance”); *Int’l Travel Arrangers, Inc. v. Western Airlines, Inc.*, 625 F.2d 1255 (8<sup>th</sup> Cir. 1980) (dominant firm’s exclusionary conduct included a false, misleading and deceptive newspaper ad). Managers at one pizza chain were recently charged with arson after allegedly burning down a rival’s nearby store in order to increase sales, though no antitrust violation was apparently charged. *Florida Domino’s Managers Charged With Burning Down Rival Pizza Parlor*, FOXNEWS.COM, Oct. 29, 2011, *available at* <http://www.foxnews.com/us/2011/10/29/florida-dominos-managers-charged-with-burning-down-rival-pizza-parlor/print#ixzz1d1mfXJ3B>. Business torts can exclude rivals without harming competition, though, and thus do not necessarily also constitute violations of the antitaws.

<sup>54</sup> *Walker Process Equip. Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172 (1965).

<sup>55</sup> *E.g.*, *C.R. Bard, Inc. v. M3 Sys., Inc.*, 157 F.3d 1340, 1383 (Fed. Cir. 1998). A deceptive misrepresentation concerning incompatibility may similarly harm competition if believed. *See* Joseph Farrell, Janis K. Pappalardo & Howard Shelanski, *Economics at the FTC: Mergers, Dominant-Firm Conduct, and Consumer Behavior*, 37 REV. INDUS. ORG. 263, 268 (2010) (discussing FTC complaint against Intel resolved by consent settlement based in part on this theory).

<sup>56</sup> Several related exclusion scenarios are suggested by the case law. All suppose that a standard-setting organization (SSO) selects a particular technology owned by firm A in preference to alternative technologies, conditional on a representation by the firm that it does not have intellectual property covering the standard or that it will abide by a commitment to license on a non-discriminatory basis and charge reasonable royalties if the technology is selected. After the technology is incorporated into the standard, and firms adopting the standard make sunk investments to use it (become locked-in), firm A acts inconsistently with the commitment, as by asserting intellectual property rights and charging royalties, *see In re Dell Computer Corp.*, 121 F.T.C. 616 (1996), charging unreasonably high royalties, or preventing firms from using its intellectual property if they compete with it in the sale of products that incorporate the standard. *See Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 316 (3d Cir. 2007).

<sup>57</sup> *Cal. Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508 (1972).

<sup>58</sup> *See, e.g.*, *Andrx Pharm., Inc. v. Biovail Corp.*, 256 F.3d 799 (D.C. Cir. 2001) (allegedly excluded rival may be able to satisfy antitrust injury standard in alleging harm based on excluding firm manipulation of a statutory scheme for regulatory approval of generic drugs).



rivals may be less direct but equally harmful. A vertically-integrated dominant firm can refuse to sell a key input to rivals,<sup>59</sup> or degrade the quality of the input it provides, as by refusing to sell the highest quality inputs.<sup>60</sup> A vertical merger may threaten anticompetitive exclusion by conferring an incentive for the merged firm unilaterally to foreclose upstream rivals from access to distribution (customer foreclosure) or unilaterally to foreclose downstream rivals from access to a key input (input foreclosure).<sup>61</sup> A dominant firm can exclude its rivals by refusing to deal with their suppliers, thereby discouraging the suppliers from dealing with competing firms.<sup>62</sup> A dominant firm that sells complementary products can take customers away from an unintegrated rival, thereby reducing the rival's scale of operations and so raising its costs. The dominant firm can also accomplish the same end by tying complementary products together,<sup>63</sup>

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<sup>59</sup> *E.g.*, *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1983) (firm controlling three of the four mountains at a leading destination ski resort excluded the company owning the fourth mountain from participating in a multi-area ski ticket, making it difficult for the excluded firm to attract customers scheduling week-long ski vacations).

<sup>60</sup> *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007) (major local telephone companies, which had different territorial footprints, allegedly acted in concert to evade their statutory obligation to interconnect with new rivals by making interconnection costly and cumbersome or providing low quality connections).

<sup>61</sup> Memorandum Opinion and Order, *Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc. For Consent to Assign Licenses and Transfer Control of Licenses*, -- FCC Rcd. -- (2011) (Comcast could disadvantage rival video distributors by denying them access to NBC programming or raising the price, and disadvantage rival programming suppliers by denying them access to Comcast's video distribution customers or charging them more), *available at* <http://transition.fcc.gov/transaction/comcast-nbcu.html>.

<sup>62</sup> *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951) (monopolist newspaper refused to accept ads from firms that advertised on a new radio station).

<sup>63</sup> *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1992) (Kodak allegedly tied copier parts to copier service in order to exclude independent service operators). Under some conditions, excluding firms can successfully employ tying or bundling as an exclusionary strategy. *E.g.*, John Simpson & Abraham L. Wickelgren, *Bundled Discounts, Leverage Theory, and Downstream Competition*, 9 AM. L. & ECON. REV. 370 (2007); Dennis W. Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 RAND J. ECON. 194 (2002); Michael D. Whinston, *Exclusivity and Tying in U.S. v. Microsoft: What We Know, and Don't Know*, 15 J. ECON. PERSP. 63 (2001); Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837 (1990). Other explanations for tying include price discrimination, which could either harm or promote competition, and an effort to achieve efficiencies such as scale or scope economies for sellers or a reduction in transactions costs for buyers. *E.g.*, Marius Schwartz & Daniel Vincent, *Quantity Forcing and Exclusion: Bundled Discounts and Nonlinear Pricing*, in 2 ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY 939 (2008); David S. Evans & Michael Salinger, *Why Do Firms Bundle and Tie? Evidence from Competitive Markets and Implications for Tying Law*, 22 YALE J. ON REG. 38 (2005).

offering discounts to buyers purchasing a package of products,<sup>64</sup> or offering discounts to buyers based on the share of the buyer's total input purchases accounted for by the excluding seller.<sup>65</sup> Similar exclusionary strategies to those set forth above could be employed by a group of excluding firms acting collectively to harm a rival, as through an exclusionary group boycott,<sup>66</sup> parallel exclusionary conduct,<sup>67</sup> or pooling weak patents.<sup>68</sup>

*Purchase of an Exclusionary Right.* The exclusionary strategies in the second category require the cooperation of non-excluding firms to raise rivals' costs, as through vertical agreement. A firm can foreclose its rivals by contracting with sellers of key inputs, inexpensive distribution, or other complementary products or services to raise the price that rivals must pay for the complement or to deny rivals access to that product entirely.<sup>69</sup> A dominant firm may also employ other contracting strategies to raise rivals' costs. It may overbuy a key input to bid up the market price; this may be worth it if the higher input price forces rivals to exit,<sup>70</sup> or if the strategy

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<sup>64</sup> *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883 (9th Cir. 2008).

<sup>65</sup> See Joseph Farrell, Janis K. Pappalardo & Howard Shelanski, *Economics at the FTC: Mergers, Dominant-Firm Conduct, and Consumer Behavior*, 37 REV. INDUS. ORG. 263, 267 (2010) (discussing FTC complaint resolved by consent settlement based on this theory). Market share discounts could exclude rivals through two distinct economic mechanisms. First, they may operate like a tax on incremental buyer purchases from competitors. Joseph Farrell, Janis K. Pappalardo & Howard Shelanski, *Economics at the FTC: Mergers, Dominant-Firm Conduct, and Consumer Behavior*, 37 REV. INDUS. ORG. 263, 267 (2010). Second, if rivals' marginal costs increase as their output falls, market share discounts (like quantity discounts) could shift sales away from rivals, thereby raising rivals' costs by denying them economies of scale.

<sup>66</sup> *E.g.*, *Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co.*, 472 U.S. 284 (1985) (office supply store members of a purchasing cooperative expelled a rival).

<sup>67</sup> See generally Scott Hemphill & Tim Wu, *Parallel Exclusion*, YALE L.J. (forthcoming).

<sup>68</sup> *United States v. Singer Mfg. Co.*, 374 U.S. 174 (1963). The pooling of patents that would be essential (or otherwise substitutes) if valid could harm competition through exclusion by reducing the likelihood that questionable patents would be reviewed for validity. Pooling could also benefit competition if used to avoid costly litigation over patent boundaries.

<sup>69</sup> Alcoa, the early 20<sup>th</sup> century aluminum monopolist, entered into contracts with hydroelectric power producers that forbade the power companies from supplying electricity to other aluminum manufacturers. See *United States v. Aluminum Co. of America*, 148 F.2d 416, 422 (2d Cir. 1945) (Alcoa) (describing 1912 government enforcement action). See also *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181 (3d Cir. 2005); *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (exclusionary agreements between Microsoft and Original Equipment Manufacturers and Internet Access Providers). When the excluded firm is forced to adopt a higher cost method of distribution, this exclusionary strategy is sometimes described as disrupting an optimal distribution strategy.

<sup>70</sup> *E.g.*, *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007) (dominant seller of hardwood lumber protected the market power of its hardwood lumber mills by bidding up the price of logs, in order to force a rival mill to exit).

raises competitors' marginal costs, and thus increases the market price by more than the dominant firm's own average costs rise.<sup>71</sup> The dominant firm may also exclude rivals by contracting with suppliers to give the monopolist the benefit of any discount the suppliers offer a rival.<sup>72</sup>

*Commitment to Tough Competition.* In the third category of exclusionary strategies, excluding firms, perhaps especially dominant firms, scare off competition through commitments that convince rivals that aggressive conduct will be met with a strong response. Such a strategy works when the rivals conclude that their best response is to live and let live – to avoid entry, price-cutting, or other competitive moves that would provoke the giant.<sup>73</sup> The leading antitrust example involves predatory pricing: a multimarket monopolist may respond aggressively to single market entry, and profit from doing so mainly by discouraging entry in other markets, allowing the monopolist to protect its market power there.<sup>74</sup>

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Overbuying could alternatively be viewed as a constraint on rival conduct, and placed in the first category.

<sup>71</sup> In general, a firm's marginal cost is the cost concept relevant to determining its price, while its average cost is the cost concept relevant to determining its profitability.

<sup>72</sup> *E.g.*, *Comp., United States v. Blue Cross Blue Shield of Mich.*; No. 2:10-CV-14155-DPH-MKM (E.D. Mich. Oct. 18, 2010), *available at* <http://www.justice.gov/atr/cases/f263200/263235.htm>; *United States v. Delta Dental of R.I.*, 943 F. Supp. 172 (D.R.I. 1996). These contractual provisions are termed "most favored nations" or "most favored customer" clauses. They can protect the dominant firm from new competition by making it impossible for an entrant to obtain key inputs cheaply from suppliers that might have been willing to give the entrant a discount in exchange for a large share of the entrant's business. Most favored customer provisions can also harm competition by facilitating coordination. *See generally* Jonathan B. Baker, *Vertical Restraints with Horizontal Consequences: Competitive Effects of "Most-Favored-Customer" Clauses*, 64 ANTITRUST L. J. 517 (1996).

<sup>73</sup> *See generally* Steven C. Salop, *Strategic Entry Deterrence*, 69 AM. ECON. REV. 335 (Papers & Proceedings, May 1979) (excluding firms can make investments that commit them to an aggressive response to future rivalry, with the consequence that future competition is deterred); Richard J. Gilbert, *Mobility Barriers and the Value of Incumbency*, in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 475 (Richard Schmalensee & Robert Willig, eds., 1989) (same). *See also* JOHN SUTTON, *SUNK COSTS AND MARKET STRUCTURE* (1981) (excluding firms may be able to deter entry by raising a new firm's post-entry marginal costs of production and distribution, as through investments that have the effect of increasing the sunk investments a new firm must make on marketing or research and development if it chooses to enter).

<sup>74</sup> *Spirit Airlines, Inc. v. Nw. Airlines, Inc.*, 431 F.3d 917 (6th Cir. 2005). A predator may also succeed by convincing lenders or investors no longer to support the prey ("deep pocket" predation), by convincing a prospective entrant that the predator's costs are too low to make entry profitable (predation "cost-signaling"), or by convincing a prospective entrant that its product will be unattractive to buyers ("test-market" predation). *See generally* Patrick Bolton, Joseph Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L.J. 2239 (2000). *See also* Aaron S. Edlin, *Stopping Above-Cost Predatory Pricing*, 111 YALE L.J. 941 (2002). Predatory pricing may

In addition, a dominant firm's contract with suppliers to give the monopolist the benefit of discounts offered to rivals could be viewed as a commitment by the monopolist to match any price-reduction by a rival (as well as falling in the previous category, purchase of an exclusionary right).

### *B. Parallel Legal Rules*

The breadth of practices that could be considered exclusionary suggests that the courts take exclusion seriously. The parallel structure of the legal rules governing exclusion and collusion similarly suggests that exclusionary conduct is not assigned lower priority in antitrust law. As will be seen, both types of allegations are generally reviewed under the rule of reason, and in the emerging framework for doing so, courts employ analogous methods of truncation based importantly on the absence of a plausible efficiency justification.<sup>75</sup> The parallelism in legal rules is not primarily a legacy of antitrust's historical reliance on doctrinal categories that encompass both exclusionary and collusive conduct,<sup>76</sup> as the truncation methods reflect a

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also succeed by denying the prey economies of scale when the predator has more captive buyers. Chiara Fumagalli & Massimo Motta, *A Simple Theory of Predation*, (IGIER Working Paper No. 437, 2012) available at <http://www.igier.unibocconi.it/files/437.pdf>.

<sup>75</sup> The terms "truncated" or "structured" refer to a collection of analytical approaches—per se rules, quick look rules, presumptions and burden-shifting—that potentially condition liability on a limited factual inquiry rather than requiring courts to engage in a wide-open reasonableness analysis. Limiting the factual inquiry is advantageous if it reduces the costs of operating the legal system, and provides guidance to firms seeking to comply with the antitrust laws and to generalist judges seeking to enforce those laws – under circumstances in which limiting the evidence considered is unlikely to result in erroneous decisions relative to what a fact-finder would conclude from a complete factual review. See ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* 206 (2d ed. 2008) at 103-106 (discussing benefits and costs of *per se* condemnation). In general, the errors from truncation could go in either direction: truncated rules could sweep in conduct that should not be condemned, or avoid condemning conduct that should be prohibited. Conduct that avoids condemnation on a quick look can still be reviewed under the comprehensive rule of reason.

<sup>76</sup> Antitrust's traditional legal categories do not divide perfectly along exclusion vs. collusion lines. *Supra* Section I. While exclusion cases tend to be framed as vertical agreements or mergers, or as monopolization or attempts to monopolize, those categories can also be employed to attack collusive conduct and the legal categories in which collusive cases tend to be framed, including horizontal agreements, can also be employed to attack exclusionary conduct. Within a doctrinal category, moreover, the legal rule generally does not differ depending on whether the alleged conduct is collusive or exclusionary. The rules governing group boycotts may be an exception, however. The Supreme Court's collusive group boycott decision in *F.T.C. v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411 (1990) (*SCTLA*) treated that conduct as tantamount to price-fixing among rivals. *Id.* at 423. The *SCTLA* majority did not make reference to the

modern evolution to rule of reason review. This parallelism shows that courts do not place a higher burden on plaintiffs seeking to demonstrate anticompetitive exclusionary conduct.

In both the exclusion and the collusion context, the legal rules single out for particular attention anticompetitive conduct lacking a plausible efficiency justification. The term “naked collusion” is often applied to agreements among rivals to fix prices, divide markets, or otherwise harm competition that cannot plausibly be justified as efficient.<sup>77</sup> The term “plain exclusion” will be used to describe the comparable exclusionary conduct: anticompetitive exclusion lacking a plausible efficiency justification.<sup>78</sup> So-called “cheap exclusion” is a type of plain exclusion, namely plain exclusion that is also inexpensive for the excluding firms to implement.<sup>79</sup>

It is commonplace today that agreements among rivals (which more commonly threaten collusive rather than exclusionary harms), when reviewed under Sherman Act §1, are analyzed under the rule of reason through an analysis that can be structured or truncated using quick look or burden-shifting approaches.<sup>80</sup> In consequence, a horizontal restraint can be

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Court’s then-recent exclusionary group boycott decision, *Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co.*, 472 U.S. 284 (1985). *Stationers* appears to demand a more extensive showing (perhaps including proof of market power) before applying a *per se* rule to invalidate the conduct than is required for horizontal price-fixing – though it is not possible to say more than “appears” and “perhaps” because *Stationers* does not clearly delineate the elements of the *per se* rule it applies.

<sup>77</sup> See, e.g., *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963) (“no purpose except stifling of competition”).

<sup>78</sup> The seemingly analogous term “naked exclusion” was not adopted because that phrase is used in the economics literature to describe a particular economic model. Eric B. Rasmussen, J. Mark Ramseyer & John S. Wiley, Jr., *Naked Exclusion*, 76 AM. ECON. REV. 921 (1986). But see Jonathan M. Jacobson, *Exclusive Dealing, “Foreclosure,” and Consumer Harm*, 70 ANTITRUST L. J. 311, 360 (2002) (referring to “naked” exclusion); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price*, 96 YALE L.J. 209, 227 (1986) (same). Plain exclusion in a Sherman Act §2 setting has been referred to as “no efficiency justification” monopolization. Harry First, *The Case for Antitrust Civil Penalties*, 76 ANTITRUST L.J. 127, 160 (2009).

<sup>79</sup> Susan A. Creighton, D. Bruce Hoffman, Thomas G. Krattenmaker & Ernest A. Nagata, *Cheap Exclusion*, 72 ANTITRUST L.J. 975 (2005). See also Patricia Schultheiss & William E. Cohen, *Cheap Exclusion: Role and Limits* (Jan. 14, 2009), available at <http://www.ftc.gov/os/sectiontwohearings/docs/section2cheapexclusion.pdf>. The concept of cheap exclusion was developed in part as a guide to the enforcement agencies in allocating investigative resources, and incorporated the expense of implementation on the view that it would be related to the likelihood of uncovering anticompetitive exclusion.

<sup>80</sup> See generally Andrew I. Gavil, *Moving Beyond Caricature and Characterization: The Modern Rule of Reason in Practice*, 85 So. Cal. L. Rev. 733 (2012); cf. ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* 206 (2d ed. 2008) (plaintiffs

condemned without a comprehensive analysis of its effects on competition if three elements are demonstrated: (a) an agreement among rivals,<sup>81</sup> (b) certain facts suggesting the likelihood of harm to competition; and (c) the absence of a plausible efficiency justification for the agreement at issue. The second element may be satisfied by showing that the conduct falls in a traditional per se category (price-fixing or market division),<sup>82</sup> by showing that anticompetitive effect is intuitively obvious based on facial analysis of the agreement,<sup>83</sup> or (with retrospective conduct) through actual effects evidence demonstrating that competition has been harmed.<sup>84</sup>

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seek courts to truncate the rule of reason review of horizontal restraints in order “to condemn conduct without detailed analysis of market power and likely effects” when the conduct “is facially objectionable or has actual adverse effects,” and to do so when the conduct “would be in a traditional per se category but for plausible efficiencies, and on review the efficiencies do not actually appear substantial”). Courts may also consider truncating the rule of reason review of horizontal restraints in order to exculpate conduct when defendants collectively have a low market share. *Id.* at 206. In the context of burden-shifting, however, this possibility would presumably be considered only after both plaintiff and defendant have satisfied their initial burdens of production.

<sup>81</sup> Application of Sherman Act §1 is predicated on proof of agreement; the rules discussed in this paragraph govern the analysis of agreements among (horizontal) competitors. The agreement element often goes undisputed, but if an agreement among rivals must be inferred from circumstantial evidence, that element may be difficult to assess. *See generally* Louis Kaplow, *An Economic Approach to Price Fixing*, 77 ANTITRUST L.J. 343 (2011); Louis Kaplow, *Direct vs. Communications-Based Prohibitions on Price-Fixing*, J. L. ANALYSIS (forthcoming 2011), available at <http://ssrn.com/abstract=1892095>; Jonathan B. Baker, *Two Sherman Act Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 38 ANTITRUST BULL. 143 (1993). Antitrust law could in theory condemn collusive conduct on a truncated basis without proof of agreement among rivals if the other elements of the truncated rule are present, but the limited experience with identifying collusive effects from unilateral conduct after *Ethyl* and from vertical agreements after *GTE Sylvania* and *Leegin* offers little guidance as to when or under what circumstances courts would do so. *See generally* E.I. Du Pont de Nemours & Co. v. Fed. Trade Comm’n, 729 F.2d 128 (2d Cir. 1984) (*Ethyl*); *Cont’l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (non-price restraints); *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (resale price maintenance).

<sup>82</sup> *E.g.*, *Broadcast Music Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979) (horizontal price-fixing); *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46 (1990) (horizontal market division). The Supreme Court has also recognized that a collusive group boycott is tantamount to horizontal price-fixing. *F.T.C. v. Superior Court Trial Lawyers Ass’n*, 493 U.S. 411 (1990) (*SCTLA*).

<sup>83</sup> *E.g.*, *Polygram Holding, Inc. v. F.T.C.*, 416 F.3d 29, 36 (D.C. Cir. 2005) (“If, based upon economic learning and the experience of the market, it is obvious that a restraint of trade likely impairs competition, then the restraint is presumed unlawful ...”) (finding this criterion satisfied by an agreement between joint venturers to restrain price cutting and advertising with respect to products not part of the joint venture).

<sup>84</sup> *E.g.*, *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85 (1984); *FTC v. Ind. Fed’n of Dentists*, 476 U.S. 447 (1986). *But cf.* *Republic Tobacco Co. v. N. Atlantic*

This approach is typically implemented today through a burden-shifting framework that has been developed by the lower courts in agreement cases alleging collusive effects.<sup>85</sup> Plaintiff must satisfy an initial burden of production by demonstrating likely harm to competition.<sup>86</sup> If plaintiff makes a satisfactory initial showing, the burden of production shifts to defendants to identify a plausible business justification. If defendant does so, the plaintiff, on whom the burden of persuasion rests, must prove unreasonableness by showing that the harm to competition is not dissipated or eliminated by the benefit to competition,<sup>87</sup> or that defendant had a

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Trading Co., 381 F. 3d 717, 737 (7<sup>th</sup> Cir. 2004) (*Ind. Fed'n of Dentists* does not allow plaintiff to dispense entirely with market definition by proffering actual effects evidence; plaintiff must still show the “rough contours” of a market and that defendant commands a substantial share). In a retrospective exclusion case, for example, proof that prices rose after a rival was excluded might count as actual effects evidence. (Actual effects evidence can be rebutted – in this example, perhaps, with evidence that non-excluded firms experienced an independent increase in marginal cost of sufficient magnitude to explain the price increase.)

<sup>85</sup> *E.g.*, *Polygram Holding, Inc. v. F.T.C.*, 416 F.3d 29, 36 (D.C. Cir. 2005); *Law v. NCAA*, 134 F.3d 1010, 1019 (10<sup>th</sup> Cir. 1998). See generally Andrew I. Gavil, *Moving Beyond Caricature and Characterization: The Modern Rule of Reason in Practice*, 85 SO. CAL. L. REV. 733 (2012); Andrew I. Gavil, *Burden of Proof in U.S. Antitrust Law*, in ABA SECTION OF ANTITRUST LAW, 1 ISSUES IN COMPETITION LAW AND POLICY 125, 145-48 (2008).

<sup>86</sup> Plaintiff may meet this burden with any of the limited factual showings of harm to competition that would provide a basis for truncated or quick look condemnation: that the agreement falls in a traditional per se category, that harm is intuitively obvious, or that harm has already occurred (actual effects evidence). Because the plaintiff also has the option of proving unreasonableness through a comprehensive rule of reason review, plaintiff can also satisfy its initial burden with a more detailed demonstration of harm to competition based on an analysis of a wider range factors such as defendant market power or the actual effects of the agreement as implemented – in which case the plaintiff’s initial burden of production would merge with its ultimate burden of persuasion. In practical application under Sherman Act §1, most plaintiffs have failed to satisfy their initial burden. Michael A. Carrier, *The Real Rule of Reason: Bridging the Disconnect*, 1999 BYU L. REV. 1265, 1293; Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827 (2009).

<sup>87</sup> Courts routinely describe the unstructured reasonableness inquiry in terms of balancing benefits and harms, but in practice they almost never actually balance. Michael A. Carrier, *The Real Rule of Reason: Bridging the Disconnect*, 1999 BYU L. REV. 1265; Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827 (2009). Accordingly, following a suggestion of Prof. Andrew Gavil, this article describes reasonableness review as evaluating whether the benefits “dissipate or eliminate” the harms rather than as “balancing” or “weighing” harms against benefits. If a court were to permit efficiency benefits in one market to justify conduct that harmed competition in a different market, however, it would be difficult to interpret that process other than as balancing. *Cf.* U.S. Dep’t of Justice & Fed. Trade Comm’n, *Horizontal Merger Guidelines* §10 n.14 (2010), available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.html> (“The Agencies normally

practical less restrictive alternative for achieving the benefits with less harm to competition.<sup>88</sup>

The burden-shifting framework implies that the rule of reason review of allegedly collusive horizontal agreements can be truncated relative to the way a court would proceed under the comprehensive rule of reason in two senses.<sup>89</sup> First, a plaintiff may satisfy its initial burden without undertaking a detailed market analysis (which would require defining markets, analyzing market shares, evaluating entry conditions, and the like), by relying instead upon categorization of the agreement, facial analysis of the agreement, or actual effects evidence. In addition, harm to competition may be inferred from the limited showing required to satisfy plaintiff's initial burden combined with the absence of plausible efficiencies, without need for further analysis.

The courts appear to be developing a structured approach for evaluating anticompetitive exclusion similar to the approach they apply to evaluate anticompetitive collusion. As with alleged collusive harms, allegations of anticompetitive exclusion are generally tested under the rule of reason across doctrinal categories.<sup>90</sup> Exclusive dealing allegations are evaluated for their reasonableness, whether challenged under the Sherman Act or the Clayton Act.<sup>91</sup> Vertical agreements, which could result in exclusion, are reviewed under the rule of reason regardless of whether they involve price

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assess competition in each relevant market affected by a merger independently . . . . In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s).”).

<sup>88</sup> For one court's statement of this framework, see *Law v. NCAA*, 134 F.3d 1010 (10th Cir. 1998); see also *Gregory v. Fort Bridger Rendezvous Ass'n*, 448 F.3d 1195, 1205 (10th Cir. 2006) (reaffirming *Law* framework). For a collection of cases, see ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 62 n. 353 (7th ed. 2012).

<sup>89</sup> This article uses the phrases “comprehensive rule of reason,” “unstructured rule of reason,” and “full blown rule of reason” interchangeably to refer to the type of wide-ranging analysis undertaken in *Bd. of Trade of City of Chicago v. United States*, 246 U.S. 231 (1918).

<sup>90</sup> Many economic factors relevant to showing that exclusion and collusion have harmed competition, discussed below in Sections III and IV, would be relevant when applying the unstructured rule of reason, but are not all relevant if the reasonableness review is truncated.

<sup>91</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 44–45 (1984) (O'Connor, J., concurring) (Sherman Act); *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1162 (9th Cir. 1997) (Clayton Act); *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 593 (1st Cir. 1993) (Sherman Act). See Jonathan M. Jacobson, *Exclusive Dealing, “Foreclosure,” and Consumer Harm*, 70 ANTITRUST L. J. 311, 363 (2002) (exclusive dealing analysis has been “freed . . . to conform to more general analysis of trade restraints under the rule of reason”).



or non-price terms.<sup>92</sup> Tying and exclusionary group boycotts are evaluated under the rule of reason if a per se rule does not apply.<sup>93</sup> The exclusionary conduct element of the monopolization offense is reviewed in a burden-shifting framework similar to the approach now applied to evaluate the reasonableness of conduct under Sherman Act §1.<sup>94</sup>

The courts have also arguably begun to develop an approach for truncating the rule of reason review of exclusionary conduct across legal categories, much as they have come to do with collusive horizontal agreements. Synthesizing the leading cases, exclusionary conduct may be found unreasonable today without a comprehensive analysis of the nature, history, purpose, and actual or probable effect of the practice in the presence of two additional elements: if the excluding firms have foreclosed competition from all actual or potential rivals other than insignificant competitors,<sup>95</sup> and if the exclusionary conduct lacks a plausible efficiency

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<sup>92</sup> *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (non-price restraints); *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (resale price maintenance).

<sup>93</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 29 (1984) (tying); *United States v. Microsoft Corp.*, 253 F.3d 34, 84 (D.C. Cir. 2001) (tying); *see* *Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co.*, 472 U.S. 284, 297 (1985) (exclusionary group boycott); *United States v. Visa U.S.A., Inc.*, 344 F.3d 229 (2d Cir. 2003) (conduct tantamount to exclusionary group boycott analyzed under the rule of reason).

<sup>94</sup> *Compare* *United States v. Microsoft Corp.*, 253 F.3d 34, 58–59 (D.C. Cir. 2001) *with* *Polygram Holding, Inc. v. F.T.C.*, 416 F.3d 29 (D.C. Cir. 2005) *and* *Law v. NCAA*, 134 F.3d 1010 (10th Cir. 1998). *Cf.* *United States v. Standard Oil. Co.*, 221 U.S. 1, 61–62 (1911) (the rule of reason applies to the analysis of conduct under both Sherman Act §1 and Sherman Act §2). The reasonableness analysis of monopolization is structured further when price-cutting is the alleged exclusionary act, as predatory pricing requires proof of below-cost pricing and an assessment of the price-cutter's prospects for recouping the costs of below-cost pricing through the later exercise of monopoly power. *See* *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (Robinson-Patman Act decision applying Sherman Act principles). The recoupment inquiry can be understood as assessing the profitability of the alleged anticompetitive strategy, and thus evaluating whether the excluding firms can solve the third "exclusion problem" discussed below in Section IV.

<sup>95</sup> *Aspen Skiing v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) (a dominant firm excludes its only competitor); *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (exclusionary conduct protected the "applications barrier to entry" that insulated the dominant firm from competition from current and potential rivals); *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181 (3d Cir. 2005) (dominant firm foreclosed its rivals from access to dealers; while this exclusionary method did not cover two small rivals, which sold directly to the ultimate customers, their alternative method of distribution was less effective); *see* *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951) (dominant daily newspaper excluded rival radio station from advertising market but did not exclude a weekly newspaper). The Supreme Court and the district court appear to have treated the small weekly newspaper as an insignificant market participant, in which case the exclusionary conduct foreclosed only the sole *significant* rival, but these decisions could

justification.<sup>96</sup> Truncated condemnation on this basis appears possible across most if not all of the disparate legal categories in which exclusionary conduct allegations may be evaluated, including attempt to monopolize,<sup>97</sup> monopolization,<sup>98</sup> exclusionary group boycott,<sup>99</sup> non-price vertical restraints,<sup>100</sup> and exclusive dealing.<sup>101</sup> Although this truncation approach

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instead be read to have defined the market narrow to exclude that firm as a participant. *United States v. Lorain Journal Co.*, 92 F. Supp. 794, 796 -97 (N. D. Ohio 1950), *aff'd*, 342 U.S. 143 (1951). It is not necessary to identify with specificity every foreclosed rival to determine that all such rivals were excluded. See Memorandum Opinion and Order, *Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc. For Consent to Assign Licenses and Transfer Control of Licensees*, -- FCC Rcd. -- ¶¶ 39-43, 61 (2011), available at <http://transition.fcc.gov/transaction/comcast-nbcu.html>; cf. *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (inferring causal link between defendant's anticompetitive conduct and maintenance of its monopoly from the exclusion of nascent competitive threats, but not identifying each excluded potential rival).

<sup>96</sup> See Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 ANTITRUST L.J. 3, 27 (2004) (plaintiffs are most likely to succeed in proving exclusionary violations under Sherman Act §2 when the harm to competition or defendant's market power are obvious and defendant lacks a plausible business justification); cf. *United States v. Visa*, 344 F.3d 229 (2d Cir. 2003) (government prevailed by showing harm to competition and the absence of procompetitive benefits, though the inquiry into competitive harm was wide-ranging). See also Mark S. Popofsky, *Defining Exclusionary Conduct: Section 2, the Rule of Reason, and the Unifying Principle Underlying Antitrust Rules*, 73 Antitrust L.J. 435, 445 (2006) (the *Microsoft* framework for evaluating exclusionary conduct under Sherman Act §2 "is virtually indistinguishable from the test courts employ under Section 1's rule of reason").

<sup>97</sup> See *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951) (dominant daily newspaper excluded rival radio station from advertising market). Neither the Supreme Court nor the district court make clear whether advertising competition from a small weekly newspaper in the same city was ruled out by defining the market to exclude that firm as a participant – in which case the exclusionary conduct at issue foreclosed competition from all rivals – or whether it treated that firm as an insignificant market participant, in which case the exclusionary conduct foreclosed only the sole significant rival. *United States v. Lorain Journal Co.*, 92 F. Supp. 794, 796 -97 (N. D. Ohio 1950), *aff'd*, 342 U.S. 143 (1951).

<sup>98</sup> *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001); *Aspen Skiing v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985). Cf. Jonathan B. Baker, *Promoting Innovation Competition Through the Aspen/Kodak Rule*, 7 GEO. MASON L. REV. 495, 496 (1999) (explaining that the Supreme Court had established a truncated legal rule finding a violation of Sherman Act §2 when a monopolist excludes rivals by restricting a complementary or collaborative relationship without an adequate business justification).

<sup>99</sup> See *Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co.*, 472 U.S. 284 (1985) (remanding for review under legal rule creating the possibility of truncated condemnation). The *Stationers* Court used the term "per se rule," but, in contrast to the traditional per se rules employed in the analysis of horizontal restraints, conditioned application of its rule on up to three elements including defendant market power. See *infra* note 111. For this reason, its approach is better thought of as describing a truncated or structured inquiry. *Accord*, *Toys "R" Us, Inc. v. F.T.C.*, 221 F.3d 928, 936 (7<sup>th</sup> Cir. 2000).

<sup>100</sup> See *Graphic Products Distribs., Inc. v. ITEK Corp.*, 717 F.2d 1560 (11<sup>th</sup> Cir. 1983)

requires identification of the excluding firms' rivals, doing so does not undermine the benefits of truncation in reducing transactions costs and providing guidance when market definition is not difficult,<sup>102</sup> and may not fully undermine those benefits even if market definition is strongly contested.

The case law establishing the truncated approach to reasonableness review of exclusionary conduct does so more clearly in some legal categories, particularly monopolization, than in others.<sup>103</sup> Many more collusion cases have been condemned after truncated review than exclusion cases, most likely because the enforcement agencies more frequently challenge naked collusion than plain exclusion,<sup>104</sup> so the specifics of the structured approach are less evident in the exclusion context than the collusive one.<sup>105</sup> It is nevertheless evident that as the legal rules governing

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(affirming jury verdict for plaintiff upon proof of defendant market power absent evidence that the restraints were reasonably necessary to achieve a legitimate business purpose); *cf.* *Eiberger v. Sony Corp.*, 622 F.2d 1068 (2d Cir. 1980) (unjustified exclusion condemned without inquiry into defendant market power); Andrew I. Gavil, *Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance*, 72 ANTITRUST L.J. 3, 8 n.29 (2004) (*Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), “strongly implies that if a plaintiff can demonstrate that its supplier possesses market power, the burden of production should shift to the defendant to justify its conduct”). Although non-price vertical restraints can be subject to truncated condemnation, rule of reason litigation of such agreements almost always ends with defendant prevailing. HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* §11.6b (4th ed. 2011); Andrew I. Gavil, William E. Kovacic & Jonathan B. Baker, *Sidebar 4-1: Dealer Relations After Sylvania*, in *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* 369 (2d ed. 2008).

<sup>101</sup> *Cf.* *United States v. Dentsply Int'l., Inc.*, 399 F.3d 181 (3d Cir. 2005) (exclusive dealing conduct analyzed as monopolization).

<sup>102</sup> Market definition appears to have been uncontroversial in a number of pro-plaintiff exclusion decisions. *E.g.*, *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951) (the mass dissemination of news and advertising, both of a local and national character, in Lorain, Ohio); *U.S. v. Dentsply Int'l., Inc.*, 399 F.3d 181 (3d Cir. 2005) (sale of prefabricated artificial teeth in the United States); *Conwood v. United States Tobacco*, 290 F.3d 768 (6<sup>th</sup> Cir. 2002) (moist snuff in the U.S.). *Cf.* *Republic Tobacco Co. v. N. Atlantic Trading Co.*, 381 F. 3d 717, 737 (7<sup>th</sup> Cir. 2004) (the approximate magnitude of market shares may be assessed after proving the “rough contours” of a market). By contrast, the second element in the truncated reasonableness review of collusive conduct does not require market definition.

<sup>103</sup> For this reason, the cases could be read as establishing a burden-shifting approach to truncation only for the review of monopolization allegations, but that reading would be inconsistent with the broad trend in antitrust elevating concepts over categories discussed above in Section I.

<sup>104</sup> *Cf. infra* notes 235-45 and accompanying text (discussing relative frequency of exclusion and collusion cases).

<sup>105</sup> Moreover, the small number of recent exclusion decisions consistent with the synthesized rule does not mean that there is no such rule; it more likely shows that there are

exclusion and collusion evolve, they are converging on an approach that is harsher on conduct lacking a plausible efficiency justification, regardless of whether the anticompetitive effects are exclusionary or collusive – thus demonstrating that antitrust’s doctrinal rules evaluate collusion and exclusion in a similar way, and do not tilt the scales to downplay exclusion.

The courts have not explicated as doctrine the synthesized rule for truncating the reasonableness review of exclusionary conduct set forth above.<sup>106</sup> In consequence, many questions about truncated condemnation of exclusionary conduct remain open for future refinement, including the following six.<sup>107</sup>

First, if some rivals are not excluded, what showing is required to demonstrate their competitive insignificance? As an economic matter, a firm or firms would be insignificant for this purpose if, given the cost and difficulty of output expansion, it or they would not increase sales sufficiently to undermine the post-exclusion exercise of market power. Courts that have treated non-excluded firms as insignificant have not experienced difficulty concluding that they have high costs of output expansion or low market shares,<sup>108</sup> but these factual determinations will not

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fewer litigated exclusionary conduct claims than collusive conduct claims in the first place, and that the conduct in such cases is less frequently justified by a plausible efficiency.

<sup>106</sup> An earlier work by the present author described a truncated legal rule established by the Supreme Court in two monopolization decisions: *Aspen Skiing v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) and *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992). Jonathan B. Baker, *Promoting Innovation Competition Through the Aspen/Kodak Rule*, 7 GEO. MASON L. REV. 495, 496 (1999). Under that rule, Sherman Act §2 is violated when a monopolist excludes rivals by restricting a complementary or collaborative relationship without an adequate business justification. This discussion updates that prior analysis to reflect more recent precedent. Most importantly, a number of questions about the elements of the rule that seemed open in 1999, *id.* at 503-505, have been addressed through the analytical framework set forth in *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (en banc). Moreover, the generality of the *Microsoft* framework also suggests, contrary to the cautious interpretation of the cases offered in 1999, that truncation does not turn on the means of exclusion (that is, it would not be limited to exclusionary conduct that takes the form of a restriction to a prior complementary or collaborative relationship).

<sup>107</sup> In addition, it is an open question whether truncated condemnation under the rule of reason can be applied to exclusionary conduct undertaken by or associated with the creation of joint research or production ventures, including voluntary standards development organizations, as these types of joint ventures “shall be judged on the basis of its reasonableness, taking into account all relevant factors affecting competition...” 15 U.S.C. §4302.

<sup>108</sup> A low market share may indicate competitive insignificance in this context because small firms often have difficulty expanding output inexpensively, as would be the case if they are small mainly for reasons other than aggressive competition by the excluding firms. Even if production costs are low and do not increase with output, for example, the costs of identifying and marketing to new customers often increase as output rises.

always be easy to make.<sup>109</sup> If competitive insignificance is not easily determined, the truncated rule could lose its administrative advantage over unstructured rule of reason review, leading a court to prefer not to decide the matter before it on a quick look.

Second, can proof of excluding firm market power – most likely through showing that the excluding firm or firms collectively have a substantial market share – permit the inference that *all* significant rivals, actual or potential, have been excluded or likely would be excluded from evidence that *one* such rival has been excluded? That is, if the excluding firms have market power and are able to foreclose one rival, is it reasonable to presume they have the ability and incentive to foreclose all rivals? The Federal Trade Commission answered this question in the affirmative in a decision condemning an exclusionary group boycott.<sup>110</sup> If its answer is generally accepted, truncated condemnation could be undertaken without identifying every significant rival and proving that each been excluded or likely would be excluded.<sup>111</sup> Instead, exclusionary conduct would be condemned without full rule of reason review on a showing that one or more rivals were excluded, the excluding firms possess market power and the exclusionary conduct at issue had no plausible efficiency justification.

Third, in a prospective exclusion case, if the exclusionary conduct forecloses all actual and potential rivals, and has no business justification, can it be condemned without proof that the excluding firms previously had market power – particularly regardless of the excluding firm's market share?<sup>112</sup> The obvious logic of the inference created by the synthesized rule

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<sup>109</sup> See *supra* note 102 (providing examples from exclusionary conduct cases in which courts did not find market definition difficult). Problems that arise in defining markets in exclusion settings are discussed in Jonathan B. Baker, *Market Definition: An Analytical Overview*, 74 ANTITRUST L.J. 129, 166–73 (2007).

<sup>110</sup> *Toys “R” Us, Inc.*, 126 F.T.C. 415, 590-608 (1998), *aff’d*, 221 F.3d 928 (7<sup>th</sup> Cir. 2000). Moreover, if harm to competition can be inferred from proof of market power and the absence of efficiencies, it is an open question what market share would be sufficient to satisfy the rule. In *Toys*, the FTC applied the rule to a firm it found to have a market share of more than 30% in the areas in which it did business and between 40% and 50% in many cities. *Id.* at 597-99. The risk of a false positive – in particular the risk of wrongly inferring that non-excluded rivals would be unable to counteract the harm to competition by collectively expanding output – may be greater the lower the market share threshold.

<sup>111</sup> Doing so could be consistent with the truncated condemnation approach described in *Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co.*, 472 U.S. 284 (1985), which looks to exclusion, market power, and the absence of efficiencies. But it is hard to be sure what *Stationers* requires because the Court did not clearly specify whether all three of these elements must be satisfied in the event that a court chooses not to employ comprehensive reasonableness review. In the wake of *Stationers*, the lower courts have grappled inconclusively with the issue. See generally ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 492-93 (7<sup>th</sup> ed. 2012).

<sup>112</sup> Market power in exclusion cases can also be demonstrated by actual effects

set forth above – a firm clearly can exercise market power by excluding all its rivals no matter how small its prior share – implies that proof of pre-existing market power should be unnecessary for truncated condemnation.<sup>113</sup> Moreover, that outcome is consistent with the rule governing attempted monopolization, which requires proof of a “dangerous probability” of achieving monopoly power rather than pre-existing monopoly power,<sup>114</sup> and the case law establishing that a monopoly obtained through the fraudulent acquisition of a patent violates Sherman Act §2.<sup>115</sup> Given the historical importance of defendant market share in evaluating allegations of anticompetitive exclusion outside of Sherman Act §2,<sup>116</sup> however, it is possible that a court could nevertheless require proof of excluding firm market power before truncating its reasonableness review when the case cannot be framed to fall under Section 2.<sup>117</sup>

Fourth, is truncated condemnation available in a retrospective exclusion

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evidence. *E.g.*, *Eastman Kodak Co. v. Image Technical Serv., Inc.*, 504 U.S. 451, 477 (1992) (market power may be inferred from direct evidence that prices rose and rivals were excluded); *United States v. Microsoft Corp.*, 253 F.3d 34, 51, 57 (D.C. Cir. 2001) (alternative holding on monopoly power); *ReMax Int’l v. Realty One, Inc.*, 173 F.3d 995 (6<sup>th</sup> Cir. 1999); *see* *Geneva Pharms. Tech. Corp. v. Barr Labs Inc.*, 385 F.3d 485, 500 (2d Cir. 2004) (showing of adverse effects insufficient on the facts of the case); *Tops Markets, Inc. v. Quality Markets, Inc.*, 142 F.3d 90 (2d Cir. 1998) (same).

<sup>113</sup> “A firm that seeks to create a monopoly by dynamiting its competitor’s plants does not need market power – only a saboteur and a match.” HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* §6.5 (4th ed. 2011).

<sup>114</sup> *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1993). Market shares too low to prove market power may be sufficient to show “dangerous probability.” ABA SECTION OF ANTITRUST LAW, *ANTITRUST LAW DEVELOPMENTS* 323 (7th ed. 2012).

<sup>115</sup> *Walker Process Equip. Inc. v. Food Mach. & Chem. Corp.*, 382 U.S. 172 (1965). To similar effect, suppose a firm that manipulates a standard-setting process through deception to ensure that the standard incorporates its intellectual property, giving it the potential to exercise market power by asserting intellectual property rights. This showing combined with proof that the exclusionary conduct has no legitimate business justification would likely be sufficient to prove harm to competition if there is no practical way to compete without complying with the standard. *See* *Rambus Inc. v. Fed Trade Comm’n*, 522 F.2d 456 (2008) (no antitrust violation found because the proof of exclusion was insufficient on the facts of the case). *Cf.* Note, *Deception as an Antitrust Violation*, 125 HARVARD L. REV. 1235, 1251-1254 (2011) (advocating rule permitting court to find monopolization when a monopolist’s deceptive act was reasonably capable of contributing to monopoly power, and to find an agreement to deceive unreasonable if it creates a significant anticompetitive effect).

<sup>116</sup> *See, e.g.*, ABA SECTION OF ANTITRUST LAW, *ANTITRUST LAW DEVELOPMENTS* 216 (7th ed. 2012) (“Since the early 1970s, judicial decisions [in exclusive dealing cases] have established a virtual safe harbor for market foreclosure of 20 percent or less”).

<sup>117</sup> Jonathan M. Jacobson, *Exclusive Dealing, “Foreclosure,” and Consumer Harm*, 70 ANTITRUST L. J. 311, 365 (2002) (in the reasonableness analysis of exclusive dealing within a burden-shifting framework allowing for truncated condemnation, plaintiff must prove defendant market power to satisfy its initial burden).

case without proof of market power but with a showing of actual anticompetitive effects? This approach would follow the logic of a quick look methodology established in collusive agreement cases,<sup>118</sup> and it was endorsed for anticompetitive exclusion by the Federal Trade Commission,<sup>119</sup> but it has been questioned by the Seventh Circuit.<sup>120</sup>

Fifth, how will the synthesized rule for truncating the reasonableness review of exclusionary conduct be harmonized with the rules establishing below-cost pricing and recoupment as elements of the predatory pricing offense?<sup>121</sup> Truncated condemnation is unlikely to be available in such cases because one or more of the many competitive justifications for low prices would typically appear plausible,<sup>122</sup> rather than because these elements are part of the offense. (On similar reasoning, truncated condemnation is also unlikely to be available when the exclusionary conduct involves the introduction of a (non-sham) product design improvement.<sup>123</sup>) The open question that remains, which is almost surely academic rather than having practical significance, is whether the below-cost pricing and recoupment elements would prevent truncated condemnation in a predatory case in the event no plausible justification is

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<sup>118</sup> *NCAA v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85 (1984); *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447 (1986).

<sup>119</sup> *Toys "R" Us, Inc.*, 126 F.T.C. 415, 608 (1998), *aff'd*, 221 F.3d 928 (7<sup>th</sup> Cir. 2000).

<sup>120</sup> In *Republic Tobacco Co. v. N. Atlantic Trading Co.*, 381 F.3d 717, 737 (7<sup>th</sup> Cir. 2004), the Seventh Circuit declined to allow plaintiff to dispense with market definition by proffering actual effects evidence in a vertical exclusion case. Although this position had seemingly been rejected by the Supreme Court when previously adopted by the same circuit court, *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447 (1986), *rev'g* 745 F.2d 1124 (7<sup>th</sup> Cir. 1984), the appellate court in *Republic Tobacco* interpreted *Indiana Federation of Dentists* as requiring plaintiff to show the "rough contours" of a market and that defendant commands a substantial share. That Seventh Circuit took a different view *Indiana Federation of Dentists* in an earlier exclusionary group boycott case not discussed in *Republic Tobacco*. *Wilk v. Am. Med. Ass'n*, 895 F.2d 352, 360 (7<sup>th</sup> Cir. 1990) (alternative holding).

<sup>121</sup> *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

<sup>122</sup> See Jonathan B. Baker, *Predatory Pricing after Brooke Group: An Economic Perspective*, 62 ANTITRUST L.J. 585, 587-89 (1994) (surveying procompetitive explanations for prices that might appear to be below costs). Cf. John E. Lopatka & William H. Page, 'Obvious' Consumer Harm in Antitrust Policy: The Chicago School, the Post-Chicago School and the Courts, in POST-CHICAGO DEVELOPMENTS IN ANTITRUST ANALYSIS 129 (Roger Van den Bergh, Roberto Pardolessi & Antonio Cucinotta, eds. 2002) (courts tend to have sympathy for conduct conferring short run consumer benefits and hostility for conduct conferring short run consumer harm, even when careful economic analysis might support a decision otherwise).

<sup>123</sup> *Allied Orthopedic Appliances Inc. v. Tyco Health Care Group*, 592 F.3d 991, 1000 (9<sup>th</sup> Cir. 2010). See generally Alan Devlin & Michael Jacobs, *Anticompetitive Innovation and the Quality of Invention*, 27 BERKELEY TECH. L.J. 1 (2012).

proffered.<sup>124</sup>

Sixth, what business justifications for exclusionary conduct are cognizable?<sup>125</sup> For example, can defendants justify exclusionary conduct on the ground that the opportunity to charge monopoly prices induces the excluding firms to invest in developing or marketing innovative products or production processes?<sup>126</sup> This argument would seem to be “a defense based on the assumption that competition itself is unreasonable,” and thus ruled out by the holding of *National Society of Professional Engineers*,<sup>127</sup> but dicta in *Trinko* might appear to call that conclusion into question.<sup>128</sup>

In a general sense, the truncated rule of law explicated above allows condemnation of exclusion as anticompetitive without comprehensive reasonableness upon a showing of three elements: (a) exclusionary conduct, (b) facts suggesting the likelihood of harm to competition; and (c) the absence of a plausible efficiency justification for the exclusionary conduct. The second element would be satisfied by the exclusion of all actual and potential rivals (other than insignificant ones); the open questions raise the possibility that it may also be satisfied in other ways, particularly excluding firm market power combined with the ability to foreclose at least one rival, or actual anticompetitive effects.

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<sup>124</sup> The policy bases for applying special rules to analyze predatory pricing may be questioned. One possible justification, the view that predatory pricing is extremely rare, has arguably been undermined by recent economic studies providing examples of the practice. *E.g.*, Malcolm R. Burns, *Predatory Pricing and the Acquisition Cost of Competitors*, 94 J. POL. ECON. 266 (1986); Kenneth G. Elzinga & David E. Mills, *Predatory Pricing in the Airlines Industry: Spirit Airlines v. Nw. Airlines*, in THE ANTITRUST REVOLUTION 219 (John E. Kwoka & Lawrence J. White eds., 5th ed. 2008); David Genesove & Wallace P. Mullin, *Predation and Its Rate of Return: The Sugar Industry, 1887-1914*, 37 RAND J. ECON. 47 (2006); Fiona Scott Morton, *Entry and Predation: British Shipping Cartels 1879-1929*, 6 J. ECON. & MGMT. STRATEGY 679, 714 (1997); David F. Weiman & Richard C. Levin, *Preying for Monopoly? The Case of Southern Bell Telephone Company, 1894-1912*, 102 J. POL. ECON. 103 (1994). Another possible justification, the fear that mistakes by enforcers and courts could chill precompetitive price-cutting, is discussed *infra* at notes 253-61 and accompanying text.

<sup>125</sup> In addition to the cognizability issue highlighted in the text, other issues familiar from other antitrust contexts may include the treatment of cost savings that benefit sellers but are not passed through to buyers, and whether or when to count efficiencies that benefit buyers in markets other than the market in which the harm to competition occurs.

<sup>126</sup> To similar effect, one commentator raises the possibility that a monopolist’s exclusion of rivals from access to one side of its two-sided platform could be justified by its success in making the platform more effective at attracting buyers on the other side. Jonathan M. Jacobson, *Exclusive Dealing, “Foreclosure,” and Consumer Harm*, 70 ANTITRUST L. J. 311, 361 (2002) (“one can imagine a nonfrivolous (albeit weak) argument on behalf of the *Lorain Journal* that the value of the newspaper as an advertising medium might be diluted if the same messages were available elsewhere”).

<sup>127</sup> *Nat’l Soc’y of Prof’l Eng’rs v. United States*, 435 U.S. 679, 696 (1978).

<sup>128</sup> *Verizon Commc’ns Inc. v. Trinko*, 540 U.S. 398, 406 (2004).



Describing the truncated rule for exclusion this way emphasizes its structural similarity to the truncated rule for horizontal restraints applied to collusion, which, as previously discussed,<sup>129</sup> establishes a violation on a showing of three similar general elements: (a) an agreement among rivals, (b) facts suggesting the likelihood of harm to competition; and (c) the absence of a plausible efficiency justification for the agreement. If these predicates for quick look condemnation are not satisfied, moreover, the conduct is subject to unstructured rule of reason review in each case. As a formal matter, therefore, antitrust's doctrinal rules treat plain exclusion and naked collusion comparably; they do not confer a more relaxed scrutiny on exclusionary conduct.

The structured doctrinal rules for exclusion and collusion both require the absence of a plausible efficiency justification as a predicate for truncated condemnation. This formal parallel does not mean that exclusionary conduct has been or should be condemned on truncated review as frequently as collusive conduct. Indeed, plain exclusion appears in the cases with less frequency than naked collusion, for reasons discussed below in section V.

The truncated rules differ in their first two elements. Their initial elements are obviously not the same: the exclusion rule is predicated on exclusionary conduct while the collusion rule is predicated on collusive conduct.<sup>130</sup> As will be examined in detail in section IV, moreover, the rules also differ in their second element. The facts suggesting that the collusive conduct is anticompetitive, such as price fixing or market division, differ from the facts suggesting that the exclusionary conduct is anticompetitive, such as excluding all actual or potential rivals. Yet, as section IV will explain, this difference also does not undermine the formal parallelism between the truncated rules. Rather, the second step operates similarly in both contexts by obviating the need to demonstrate the specific mechanism by which defendants solve the economic problems of making exclusion or collusion work. Those mechanisms are described in the next section, which identifies the economic relationship between exclusion and collusion.

### III. THE ECONOMICS OF ANTICOMPETITIVE EXCLUSION

The harm to competition that arises from exclusion and collusion

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<sup>129</sup> *Supra* at text accompanying note 80-84.

<sup>130</sup> The first step could have been stated more broadly and in economic language as requiring coordinated conduct rather than the more narrow concept of agreement among rivals, but, as discussed *supra* note 81, antitrust law has only limited experience in identifying collusive effects from unilateral conduct or vertical agreements and the modern case law as yet offers little guidance on how to do so.

can be understood within a common economic framework that emphasizes the close economic relationship between the two means of obtaining, maintaining or exercising market power. Because of that relationship, the economic reasons for concern about anticompetitive collusion are equally reasons for concern about anticompetitive exclusion – providing an economic basis for treating exclusion and collusion with comparable priority as antitrust violations.

#### A. *Voluntary and Involuntary Cartels*

To see the economic relationship between exclusion and collusion as means of exercising market power, consider a hypothetical soft drink industry with three participants: Coke, Pepsi and Royal Crown (RC). One can imagine these three rivals reaching an express or tacit (horizontal) agreement to act collectively as though they were a monopolist, reducing industry output in order to raise price above the competitive level.<sup>131</sup> This outcome could be termed, for reasons that will become clear, a “voluntary” cartel.

Suppose instead that RC does not want to participate in the voluntary cartel. It would prefer to compete rather than to cooperate. In the merger context, one might describe RC as a “maverick” and be concerned that a merger of RC with Coke or Pepsi would lead to coordinated competitive effects.<sup>132</sup> More generally, if RC would not go along voluntarily with the cartel that Coke and Pepsi want to create, then Coke and Pepsi could make it go along by raising RC’s costs or by making it more difficult for RC to reach customers.<sup>133</sup> With higher costs of

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<sup>131</sup> This discussion adopts the convention common in the economics literature of describing competitive harms in terms of increased prices and a reduction in output. This framework encompasses reductions in product quality, which can be understood as increases in the quality-adjusted price. It also accounts for reductions in the rate of innovation, as conduct that reduces competition also tends to discourage innovation. See generally Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation*, 74 ANTITRUST L.J. 575, 579 (2007); Carl Shapiro, *Competition and Innovation: Did Arrow Hit the Bull's Eye?*, in *The Rate and Direction of Inventive Activity Revisited* 361 (Josh Lerner & Scott Stern, eds. 2012).

<sup>132</sup> Jonathan B. Baker, *Mavericks, Mergers and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. REV. 135 (2002).

<sup>133</sup> If RC is a prospective entrant, Coke may consider a broader range of exclusionary strategies than would be available if RC is an incumbent firm. In addition to raising RC’s post-entry marginal costs of production and distribution, Coke could also make greater sunk investments in order to enter or by credibly committing to increase the post-entry competition that RC expects to face. See sources cited *supra* note 73. (The latter strategies can still be interpreted as raising RC’s marginal costs on the view that a prospective entrant’s marginal decision includes whether to enter, not just how much to produce

production or distribution, RC would be forced to cut back its output and raise price, and so permit Coke and Pepsi to reduce their output and raise their prices without fear that aggressive competition by RC would undermine their collusive efforts. The upshot is that all three firms would reduce output and raise price, similarly to what would happen if RC went along voluntarily with Coke and Pepsi's efforts to collude.<sup>134</sup> Because RC is coerced into participating through the exclusionary conduct of Coke and Pepsi, this outcome can be understood as an "involuntary" (or coerced) cartel.<sup>135</sup>

The "involuntary cartel" terminology is a less natural way of describing the outcome if Coke is a dominant firm (no Pepsi) and RC is forced to exit or deterred from entry, as anticompetitive exclusion under such circumstances would result in the creation of a literal monopolist. Even in this limiting case, though, the "involuntary cartel" terminology appropriately captures the way the excluding firm forces the excluded rival to do what a cartel participant does voluntarily: avoid aggressive competition.<sup>136</sup> The terminology captures the common adverse economic effect of collusion and exclusion, and focuses attention on it.

As the soft drink example demonstrates and the "involuntary cartel" terminology highlights, exclusion and collusion are complementary methods of obtaining market power.<sup>137</sup> It does not matter to buyers whether the cartel is voluntary or involuntary; either way, the same firms

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conditional on entry.)

<sup>134</sup> The possibility that competition could be harmed through exclusionary conduct has been well established in the economics literature for decades. *E.g.*, Steven Salop & David Scheffman, *Cost-Raising Strategies*, 36 J. INDUS. ECON. 19 (1987); Oliver Williamson, *Wage Rates as a Barrier to Entry; The Pennington Case in Perspective*, 82 Q. J. ECON. 85 (1968); Richard Nelson, *Increased Rents from Increased Costs: A Paradox of Value Theory*, 65 J. POL. ECON. 357 (1957).

<sup>135</sup> Alternatively, the collusive anticompetitive effects could be described as direct and the exclusionary effects described as indirect. ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* 45-49 (2d ed. 2008)

<sup>136</sup> The "involuntary cartel" terminology may mislead if Coke is a dominant firm, however, to the extent it (incorrectly) suggests that excluding firms must solve "cartel problems" in order for exclusion to succeed in that case.

<sup>137</sup> *Cf.* Aaron Edlin & Joseph Farrell, *Freedom to Trade and the Competitive Process* (Nat'l Bureau of Econ. Research, Working Paper No. 16818, 2011) *available at* <http://ssrn.com/abstract=1761581> (collusion and exclusion both harm competition by hindering the process through which buyers and sellers undertake potentially beneficial trades and thereby form improving coalitions); *but cf.* Thomas G. Krattenmaker, Robert H. Lande & Steven C. Salop, *Monopoly Power and Market Power in Antitrust Law*, 76 GEO. L.J. 241 (1987) (distinguishing "Stiglerian" (collusive) market power and "Bainian" (exclusionary) market power).

collectively reduce output and the price that buyers pay increases.<sup>138</sup>

Exclusion and collusion are also closely related in a second way: they are often and naturally combined by firms exercising market power.<sup>139</sup> Colluding firms may need to exclude in order for their collusive arrangement to succeed.<sup>140</sup> They may find it necessary to deter a cheating member through exclusionary conduct, or to exclude fringe rivals or new entrants in order to prevent new competition from undermining their collusive arrangement.<sup>141</sup> A recent study of multiple cartels found that many “use[] exclusionary behavior often featured in monopolization cases to ensure the effectiveness of [their] efforts to restrict output.”<sup>142</sup> Similarly, excluding firms may need to collude in order to successfully exclude,<sup>143</sup> or to profit collectively from exclusionary conduct.<sup>144</sup>

### *B. Exclusion and Economic Growth*

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<sup>138</sup> In a homogeneous product market, therefore, harmful conduct could be identified through a common simple metric, a reduction in industry output, regardless of whether the practice is collusive or exclusionary.

<sup>139</sup> This discussion illustrates the way exclusion and collusion permit the firms participating in a market to exercise market power within that market. It does not address the potential competitive consequences of monopoly leveraging (the possible exploitation of market power in one market to create market power in another market), except insofar as entry into a complementary market would facilitate entry into the market served by the excluding or colluding firms, and the excluding or colluding firms can maintain their market power in the primary market by foreclosing entry by new competitors seeking to sell the complementary product.

<sup>140</sup> See ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* 235–47 (2d ed. 2008) (colluding firms must solve three “cartel problems,” which include preventing new competition, for their arrangement to succeed).

<sup>141</sup> See *JTC Petroleum Co. v. Piasa Motor Fuels, Inc.*, 190 F.3d 775, 778 (7th Cir. 1999) (Posner, C.J.) (“JTC, a maverick, was a threat to the cartel – but only if it could find a source of supply . . . ”); See generally Jonathan B. Baker, *Mavericks, Mergers and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. REV. 135, 188–97 (2002). Exclusionary conduct may be necessary for coordination among rivals to succeed, regardless of whether the coordination itself can be challenged as an illegal agreement.

<sup>142</sup> Randal D. Heeb, William E. Kovacic, Robert C. Marshall & Leslie M. Marx, *Cartels as Two-Stage Mechanisms: Implications for the Analysis of Dominant-Firm Conduct*, 19 CHI. J. INT’L L. 213, 217 (2009).

<sup>143</sup> E.g., *Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co.*, 472 U.S. 284 (1985) (alleging agreement among rivals to exclude a competitor). See also Scott Hemphill & Tim Wu, *Parallel Exclusion*, YALE L.J. (forthcoming).

<sup>144</sup> Cf. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (rejecting predatory pricing claim in part because facts did not support oligopoly recoupment theory).

The parallel between voluntary and involuntary cartels provides an economic basis for treating exclusion and collusion as comparably serious antitrust offenses. Indeed, anticompetitive exclusion may be the more important problem because of the particular threat exclusion poses to economic growth. While collusion commonly prevents competition on only some dimensions,<sup>145</sup> often only price, complete foreclosure necessarily prevents competition on all dimensions, including innovation, and exclusionary conduct falling short of complete foreclosure commonly discourages competition across multiple dimensions.

When antitrust cases address the suppression of new technologies, products, or business models, the disputes are almost always framed as exclusionary conduct allegations.<sup>146</sup> For example, Microsoft was found to have harmed competition in personal computer operating systems by impeding the development of a new method by which applications software could access operating systems, involving the combination of Netscape's browser and Sun's Java programming language.<sup>147</sup> The D.C. Circuit explained that "it would be inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at will – particularly in industries marked by rapid technological advance and frequent paradigm shifts."<sup>148</sup> Similarly, much of the relief accepted by the Justice Department and the Federal Communications Commission in their concurrent reviews of Comcast's acquisition of NBC Universal programming aimed to protect the development of nascent competition from a new technology, online video distribution, and new business models that could threaten Comcast's market

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<sup>145</sup> Cf. Jonathan B. Baker, *Identifying Cartel Policing Under Uncertainty: The U.S. Steel Industry, 1933-1939*, 32 J. L. & Econ. S47, S58 n. 31 (1989) (the iron and steel industry's collusive Code of Fair Competition, devised by the industry during the Great Depression and promulgated by the National Recovery Administration, exempted areas of ongoing technical progress from its prohibition on the erection of new production capacity).

<sup>146</sup> *But see* United States v. Auto Mfrs. Ass'n, 307 F. Supp. 617 (C.D. Cal. 1969) (consent decree settling allegations of conspiracy to suppress automotive pollution control R&D); *but cf.* Michelle S. Goeree & Eric Helland, *Do Research Joint Ventures Serve a Collusive Function?*, TWELFTH CEPR/JIE CONF. APPLIED INDUS. ORG. (2011), available at <http://www.cepr.org/meets/wkcn/6/6691/papers/GoereeFinal-P.pdf> (providing empirical evidence that research joint ventures among rivals may facilitate collusion). For this purpose, cases alleging conspiracies to exclude, as through group boycott or predatory pricing, are counted as exclusionary. *E.g.*, Fair Allocation System, Inc., 63 Fed. Reg. 43182 (FTC 1998) (consent order settling charges that automobile dealers conspired to induce auto manufacturer to foreclosure rival dealer marketing on the Internet).

<sup>147</sup> United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001).

<sup>148</sup> *Id.* at 79.

power in cable television.<sup>149</sup> Moreover, exclusionary conduct inhibiting price competition may also harm innovation competition in the same market, as with the “exclusionary rules” adopted by Master Card and Visa to prevent member banks from issuing Amex or Discover Cards.<sup>150</sup>

The anticompetitive exclusion of new technologies is not just a modern problem. Six decades ago, the newspaper monopolist in *Lorain Journal* impeded the entry of a rival using a new technology, radio.<sup>151</sup> Had the newspaper succeeded, and other newspapers followed suit,<sup>152</sup> it is easy to imagine that few radio stations in regions with a dominant newspaper would have succeeded unless they were owned by the newspaper, slowing the growth of the radio industry.

These prominent examples make clear that antitrust is an “inclusive” economic institution that supports economic growth and prosperity by preventing successful incumbent firms and industries from erecting barriers to the entry of rivals with lower costs, superior production technologies or better products.<sup>153</sup> The main innovation-related argument otherwise does

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<sup>149</sup> Memorandum Opinion and Order, *Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc. For Consent to Assign Licenses and Transfer Control of Licensees*, -- FCC Rcd. -- (2011), available at <http://transition.fcc.gov/transaction/comcast-nbcu.html>; Competitive Impact Statement, *United States v. Comcast Corp.*, No. 1:11-cv-00106 (D.D.C. Jan. 18, 2011) available at <http://www.justice.gov/atr/cases/f266100/266158.pdf>. The transaction took the form of a joint venture between Comcast and the previous owner of the programming, General Electric, but was treated as an acquisition because Comcast controlled the joint venture and had the option to buy out General Electric.

<sup>150</sup> *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 241 (2d Cir. 2003) (upholding district court findings that exclusionary conduct stunted price competition and denied consumer access to products with new features, and that absent the exclusionary conduct, price competition and innovation in services would be enhanced).

<sup>151</sup> *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951).

<sup>152</sup> See *Kansas City Star v. U.S.*, 240 F.2d 643 (1957) (news and advertising monopolist owned multiple newspapers and radio and television broadcasting stations in the Kansas City region).

<sup>153</sup> See Daron Acemoglu & James A. Robinson, *Why Nations Fail* 38-40 (2012) (contrasting the growth-promoting economic institutions in the U.S. with the growth-inhibiting ones in Mexico by comparing Bill Gates, whose technologically innovative company was prevented from abusing its monopoly by U.S. antitrust enforcers, with Carlos Slim, whose company was conferred monopoly power and protected from competition by Mexican government institutions). Acemoglu and Robinson attribute economic growth and prosperity primarily to “inclusive” economic institutions that facilitate entry, investment, and innovation and permit less efficient firms to be replaced by more efficient ones, *id.* at 75-79, as opposed to “extractive” economic institutions that “expropriate the resources of the many, erect entry barriers, and suppress the functioning of markets so that only a few benefit.” *Id.* at 81. In their view, inclusive economic institutions are typically supported by “inclusive” political institutions that vest power in a broad coalition or plurality of political groups rather than in a narrow elite. *Id.* at 80-81, 86-87. *Accord*

not question the benefits of economic growth, whether in individual industries<sup>154</sup> or to society as a whole;<sup>155</sup> both skeptics and advocates of antitrust intervention in exclusionary conduct settings such as monopolization are concerned with the impact of competition policy on growth.<sup>156</sup> Rather, those concerned about antitrust enforcement against exclusionary conduct argue that it could discourage innovation by making it less profitable.

Their economic point is that a greater prospect of post-innovation

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STEPHEN L. PARENTE & EDWARD C. PRESCOTT, *BARRIERS TO RICHES* (2000) (attributing differences in living standards across nations importantly to competition-reducing policies within less developed countries, put into place to protect the interests of groups that benefit from current ways of production, that prevent firms from adopting better production methods). Cf. Edward L. Glaeser, *The Political Risks of Fighting Market Failures: Subversion, Populism and the Government Sponsored Enterprises 10* (Nat'l Bureau of Econ. Research, Working Paper No. 18112, 2012), available at <http://www.nber.org/papers/w18112>) ("If bargaining across firms is difficult, especially when trying to arrange for large bribes, then competition will lead to less corruption risk than monopoly).

<sup>154</sup> At the level of individual industries, studies find substantial social gains from new product introductions. For example, the welfare gain from the introduction of personal computers has been estimated to equal 2% to 3% of consumption expenditure. Jeremy Greenwood & Karen Kopecky, *Measuring the Welfare Gain from Personal Computers*, *ECON. INQUIRY* (forthcoming). Compare Jerry A. Hausman, *Valuation of New Goods Under Perfect and Imperfect Competition*, in *THE ECONOMICS OF NEW GOODS* 209 (Timothy F. Bresnahan & Robert J. Gordon, eds., 1996) (estimating substantial social welfare gains from the introduction of a differentiated consumer product) with Timothy F. Bresnahan, *The Apple-Cinnamon Cheerios War: Valuing New Goods, Identifying Market Power, and Economic Measurement* (undated unpublished manuscript), [http://www.stanford.edu/~tbres/Unpublished\\_Papers/hausman%20recomment.pdf](http://www.stanford.edu/~tbres/Unpublished_Papers/hausman%20recomment.pdf) (questioning Hausman's methodology and conclusion, but not doubting the likelihood of substantial benefits from new products in high-technology sectors). Moreover, other studies find that the social return to innovation substantially exceeds the private return. Edwin Mansfield, *Microeconomics of Technological Innovation*, in *TECHNOLOGY AND GLOBAL INDUSTRY* 311 (Bruce R. Guile & Harvey Brooks, eds., 1987); Jeffrey Bernstein & M. Isaq Nadiri, *Interindustry R&D Spillovers, Rates of Return, and Production in High-Tech Industries*, 78 *AM. ECON. REV.* 429 (1988); Zvi Griliches, *The Search for R&D Spillovers*, 94 *SCANDINAVIAN J. ECON.* S29 (Supp. 1992); Charles I. Jones & John C. Williams, *Measuring the Social Return to R&D*, 113 *Q. J. ECON.* 1119 (1998).

<sup>155</sup> See generally J. Bradford DeLong, *Cornucopia: Increasing Wealth in the Twentieth Century* (2000), [http://www.j-bradford-delong.net/tceh/2000/TCEH\\_2.html](http://www.j-bradford-delong.net/tceh/2000/TCEH_2.html).

<sup>156</sup> Compare David S. Evans & Keith N. Hylton, *The Lawful Acquisition and Exercise of Monopoly Power and Its Implications for the Objectives of Antitrust*, 4 *COMPETITION POL'Y INT'L* 203 (2008) (arguing that antitrust pays excessive attention to the static harms of monopoly pricing and insufficient attention to the dynamic benefits of dominant firm innovation) with Jonathan B. Baker, *"Dynamic Competition" Does Not Excuse Monopolization*, 4 *COMPETITION POL'Y INT'L* 243 (2008) (describing innovation benefits of antitrust enforcement against monopolization).

competition could reduce the return to innovation.<sup>157</sup> But as an argument against antitrust enforcement, it is incomplete because it does not recognize the importance of competitive forces – both pre-innovation product market competition, and competition in innovation itself – for fostering innovation and economic growth.<sup>158</sup> The latter forces are likely the more important on average.<sup>159</sup> As an argument against antitrust, the observation also does not recognize the way antitrust enforcement can target industry settings and categories of behavior where such enforcement can promote innovation.<sup>160</sup> Those settings include antitrust enforcement to foster product market competition in “winner-take-all” or “winner-take-most” industries, industries where the extent of future competition will be determined mainly by developments in technology or regulation, and rapidly growing industries<sup>161</sup> – all features that frequently characterize high technology sectors.<sup>162</sup> In short, antitrust enforcement against exclusionary conduct is

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<sup>157</sup> For example, in the model analyzed by Hylton and Lin, antitrust enforcement against the exclusionary conduct of dominant firms benefits society by lowering post-innovation consumer prices, but harms society by discouraging innovation. Keith N. Hylton & Haizhen Lin, *Optimal Antitrust Enforcement, Dynamic Competition, and Changing Economic Conditions*, 77 *Antitrust L.J.* 247 (2010). The model does not incorporate the dynamic benefits of pre-innovation competition in providing an incentive to innovate. See also *Verizon Commc’ns Inc. v. Trinko*, 540 U.S. 398, 406 (2004) (the prospect of monopoly induces risk-taking and innovation).

<sup>158</sup> See generally Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation*, 74 *ANTITRUST L.J.* 575, 579 (2007); Carl Shapiro, *Competition and Innovation: Did Arrow Hit the Bull’s Eye?*, in *The Rate and Direction of Inventive Activity Revisited* 361 (Josh Lerner & Scott Stern, eds. 2012); cf. TIM WU, *THE MASTER SWITCH: THE RISE AND FALL OF INFORMATION EMPIRES* 308 (2010) (“To grant any dominant industrial actor the protection of the state, for whatever reason, is to arrest the Schumpeterian dynamic by which innovation leads to growth, an outcome that is ultimately never in the public interest.”).

<sup>159</sup> Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation*, 74 *ANTITRUST L.J.* 575, 583-87 (2007); Carl Shapiro, *Competition and Innovation: Did Arrow Hit the Bull’s Eye?*, in *The Rate and Direction of Inventive Activity Revisited* 376-82 (Josh Lerner & Scott Stern, eds. 2012).

<sup>160</sup> Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation*, 74 *ANTITRUST L.J.* 575, 589 (2007). Cf. Jonathan B. Baker, “*Dynamic Competition*” *Does Not Excuse Monopolization*, 4 *COMPETITION POL’Y INT’L* 243 (2008) (describing innovation benefits of antitrust enforcement against monopolization).

<sup>161</sup> *Id.* at 593-98. Policies increasing pre-innovation competition in these industries – such as monopolization cases or other antitrust enforcement actions – are unlikely to make much difference to the reward to successful innovation – but can increase pre-innovation competition in both product markets and in innovation, and thus increase incentives to innovate.

<sup>162</sup> Anticompetitive conduct, whether exclusionary or collusive, can occur in rapidly-innovating high-technology industries, as illustrated by recent government enforcement efforts involving information technology providers. *E.g.*, *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (exclusion); *In re Intel Corp.*, Docket No. 9342 (Fed’l Trade



important because it fosters economic growth and prosperity, not just because it addresses harms to price competition similar to those attacked by enforcement against collusive conduct.

#### IV. DIFFERENCES BETWEEN EXCLUSION AND COLLUSION

Notwithstanding the broad parallels between voluntary and involuntary cartels, anticompetitive collusion and exclusion arise through different mechanisms. This section is concerned with the differences between these mechanisms.

As is well known, colluding firms must find a way to solve their “cartel problems”: reaching consensus on terms of coordination, deterring cheating on those terms, and preventing new competition.<sup>163</sup> Section IV.A below will show that excluding firms face the parallel challenge of finding a way to solve three “exclusion problems”: identifying an exclusionary method, excluding sufficient rivals to harm competition, and ensuring that the exclusionary conduct is profitable for each excluding firm. Section IV.B looks in detail at the factors affecting excluding firms ability to solve one of their problems, profitability, when they adopt one particular exclusionary method, purchase of an exclusionary right. This is an important exclusionary strategy, and the factors relevant to its profitability have been the subject of recent economics scholarship not well known in the antitrust context.

The methods that excluding or colluding firms exercising market power adopt to achieve an anticompetitive end could be relevant to the unstructured reasonableness analysis of that conduct under the antitrust laws. The legal discussion in section IV.C, shows that the rules employed

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Comm’n Oct. 29, 2010) (Decision and Order) (exclusion); *United States v. Adobe Systems, Inc.*, No. 1:10-cv-01629 (D.D.C. March 17, 2011) (final judgment) (collusion); *United States v. Hynix Semiconductor, Inc.*, No. CR 05-249 PJH DRAM (N.D. Cal. May 11, 2005) (plea agreement) (collusion).

<sup>163</sup> See ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* 235–47 (2d ed. 2008). These problems are connected with the Stiglerian deterrence perspective on coordination (as refined by the economic literature on oligopoly supergames). See Jonathan B. Baker, *Two Sherman Act Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 38 *ANTITRUST BULL.* 143, 149-69 (1993) (describing economics of coordination). They are not tied to the broader perspective on coordination adopted by the 2010 Horizontal Merger Guidelines. The Guidelines go beyond the Stiglerian perspective by also recognizing as coordination “parallel accommodating conduct” (high price outcomes that result from firm conduct that softens competition when firm strategies do not depend on history and rivals have accommodating reactions). U.S. Dep’t of Justice & Fed. Trade Comm’n, *Horizontal Merger Guidelines* §7 (2010), available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf>.

to truncate the review of exclusionary and collusive conduct, described above in Section II, do so in analogous ways. In each case, truncation obviates the need to demonstrate the specific mechanism defendants would or did employ to solve the relevant exclusion or cartel problems. Again, the formal structure of antitrust rules does not downplay anticompetitive exclusion.

#### A. *The Economics of “Exclusion Problems”*

For an exclusionary strategy to succeed, and thus for the excluding firms successfully to create an involuntary cartel, the excluding firms must solve three problems: identifying a practical method of exclusion, excluding rivals sufficient to ensure that competition is harmed, and ensuring profitability of their exclusionary strategy.<sup>164</sup> These three problems – method, sufficiency, and profitability – may be termed “exclusion problems,”<sup>165</sup> by analogy to the “cartel problems” colluding firms must solve in order for the coordinated arrangement to succeed.

First, the excluding firms must be able to identify a method of partially or fully excluding some or all rivals.<sup>166</sup> The possible methods include four economic mechanisms for raising rivals’ marginal input costs described by Professors Krattenmaker and Salop.<sup>167</sup> First, excluding firms may create a “bottleneck”<sup>168</sup> The excluding firms can do so by purchasing exclusionary rights from a sufficient number of the lowest-cost suppliers to

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<sup>164</sup> These exclusion problems were identified by Professors Krattenmaker and Salop in their seminal survey article on exclusionary conduct in antitrust. Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1986). In that article, Krattenmaker and Salop refer to the first exclusion problem (method) as “raising rivals’ costs,” to the second problem (sufficiency) as “gaining power over price” and to the third exclusion problem as “profitability,” using the same term employed here. The three exclusion problems set forth in the text also generalize the three conditions described as necessary for successful exclusion through vertical agreement set forth in Jonathan B. Baker, *Vertical Restraints with Horizontal Consequences: Competitive Effects of “Most-Favored-Customer” Clauses*, 64 ANTITRUST L.J. 517, 524 (1996) (explaining that the benefits of the strategy to the firms undertaking it must exceed its costs (profitability), the excluding firms must not cheat on each other (an aspect of sufficiency), and the excluded firm must be unable to avoid the strategy (method)).

<sup>165</sup> When there are multiple excluding firms, the first and second “exclusion problems” could require coordination among rivals, further illustrating the close connection between collusion and exclusion. See Scott Hemphill & Tim Wu, *Parallel Exclusion*, YALE L.J. (forthcoming) (discussing the ways excluding firms solve their “cartel problems”).

<sup>166</sup> Methods evaluated by the courts are surveyed informally in section II.A.

<sup>167</sup> Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals’ Costs to Achieve Power Over Price*, 96 YALE L.J. 209 (1986).

<sup>168</sup> *Id.* at 234.

force excluded rivals to shift to higher cost suppliers or less efficient inputs. The cost increase leads the excluded rivals to compete less aggressively with the excluding firms. Second, excluding firms may engage in “real foreclosure.”<sup>169</sup> Under this method, excluding firms purchase exclusionary rights over a substantial fraction of the supply of a key input, and, by withholding that supply, drive up the market price for the remainder of the input still available to excluded rivals. Again, higher costs would lead the excluded rivals to compete less aggressively. Third, the excluding firms may act as a “Cartel Ringmaster” by inducing multiple suppliers of a key input to sell to the excluded rivals only on disadvantageous terms, thereby reducing competition from those rivals.<sup>170</sup> Fourth, the excluding firms may create a “Frankenstein Monster.”<sup>171</sup> The excluding firms would do so by purchasing exclusionary rights from a number of suppliers of the key input, thereby increasing the likelihood that the remaining suppliers would successfully collude, expressly or tacitly, to raise price to the excluded rivals. With higher input prices, the excluded rivals would once again be led to compete less aggressively.

The economic mechanisms by which excluding firms foreclose their rivals could work through raising input prices (input foreclosure), but could also operate by reducing rivals’ access to the market (customer foreclosure). For example, if the rivals benefit from scale economies and the excluding firms adopt methods that foreclose the excluded rivals from access to low cost distribution, the excluding firms may raise their rivals’ costs by reducing their rivals’ scale.<sup>172</sup> Indeed, any economic mechanism available for input foreclosure is potentially available for customer foreclosure, and vice versa.<sup>173</sup>

If the excluded firms can inexpensively adopt counterstrategies to avoid or evade the exclusionary conduct, the excluding firms will be unable to solve the first exclusion problem, identifying an exclusionary method.<sup>174</sup> In the hypothetical soft drink example sketched in section III.A, if Coke and

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<sup>169</sup> *Id.* at 236.

<sup>170</sup> *Id.* at 238.

<sup>171</sup> *Id.* at 240.

<sup>172</sup> If the excluded rivals must produce and sell at a reduced scale, they may have higher marginal costs. If the excluded rivals can no longer achieve a minimum viable scale, those rivals would be forced to exit.

<sup>173</sup> Some conceptual gymnastics may be required to see the parallel. Consider, for example, an industry with firms at three levels: input supply, manufacturing, and distribution. Distribution may more naturally be seen as downstream of manufacturing, but it would not be inappropriate to view it alternatively as a service purchased by the manufacturer. Hence conduct excluding a rival from access to distribution could be viewed as input foreclosure as well as customer foreclosure. *See supra* note 52 & *infra* note 192.

<sup>174</sup> Krattenmaker and Salop analyze rivals’ counterstrategies solely as a profitability issue; here that issue is treated as also an aspect of the first exclusion problem.

Pepsi attempt to exclude RC by denying it access to bottlers, but RC can instead obtain comparable distribution through beer distributors at little cost penalty,<sup>175</sup> the exclusionary strategy would not be successful.<sup>176</sup> Moreover, if the method of exclusion requires coordination between Coke and Pepsi, the inquiry into method of exclusion would also include asking whether those firms could successfully coordinate.<sup>177</sup>

Second, the exclusionary conduct must be sufficient to harm competition. This condition requires in part that the excluded firm matter competitively; its exclusion must relax a competitive constraint on the excluding firms.<sup>178</sup> In addition, it requires that any remaining competition – whether from rivals not excluded or not fully excluded, from entrants, or from among the excluding firms themselves – not undermine what the relaxation of a competitive constraint has achieved for the excluding firms: their ability to raise market prices. Accordingly, the excluding firms must prevent their involuntary cartel from being undermined through repositioning or output expansion by unexcluded rivals, by the entry of new

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<sup>175</sup> This counterstrategy would be unlikely to succeed unless beer distributors can produce bottled products from concentrate.

<sup>176</sup> Although customers may have an incentive to help the excluded firms avoid foreclosure, *see* David T. Scheffman & Pablo T. Spiller, *Buyers' Strategies, Entry Barriers, and Competition*, 30 *ECON. INQUIRY* 418 (1992), they need not be able or willing to do so. Customers' ability to assist excluded firms in executing a counterstrategy is unlikely to be greater than their ability to undermine a voluntary cartel by sponsoring entry. In a market with many buyers, for example, no individual customer may have sufficient incentive to sponsor entry: doing so would be costly and each would recognize that most of the benefits would accrue to its rivals rather than itself.

<sup>177</sup> With multiple excluding firms, the excluding firms may have difficulty committing to their exclusionary method, as they may be unable to avoid the temptation to cheat on the involuntary cartel they have created by foreclosing their excluded rivals. The analysis of whether the excluding firms can successfully overcome this problem, an aspect of sufficiency, would be similar to the analysis of whether the excluding firms would cheat on the collusive arrangement that would have formed had the excluded firms joined the excluding firms voluntarily. This issue would not arise if there is only a single excluding firm, as would be the case if Coke was a dominant firm.

<sup>178</sup> An excluded firm can constrain the excluding firms competitively even if it is not as efficient as the excluding firms. For example, if the industry price is 18, the excluding firms have marginal costs of 10, and the sole excluded firm has a marginal cost of 15, competition would be harmed if the excluding firms are able to raise the price to 20 (say) through foreclosure of the excluded firm, even though the excluded firm has a higher marginal cost than the excluding firms. In this example, if the monopoly price is at least 20, it is evident that the exclusionary conduct would both raise price to consumers and increase the allocative efficiency loss that arises when price exceeds marginal cost. If foreclosure of an inefficient firm allows a lower cost firm to expand output in its place, as may or may not occur, the resulting production cost savings would create a countervailing benefit to aggregate welfare (although that benefit would not be cognizable if the welfare criterion looks solely to consumers).

competitors, or by cheating among the excluding firms. In a prospective exclusion case, the ability of excluding firms to solve the sufficiency problem might be inferred from an analysis of market structure,<sup>179</sup> or from past history of successful exclusion. In a retrospective exclusion case, where market definition may be more difficult,<sup>180</sup> evidence of actual competitive effects may also be available.<sup>181</sup>

Finally, the exclusionary conduct must be profitable for each excluding firm.<sup>182</sup> Each must reasonably expect the additional profits it will obtain or maintain through the successful operation of an involuntary cartel would exceed the costs it incurs in achieving that arrangement.<sup>183</sup> The costs might include, for example, payments to sellers of complements that agree to exclude rivals, forgone revenues from reducing price below what the excluding firms might otherwise charge (*e.g.*, if predatory pricing is alleged as the exclusionary mechanism), or forgone profits on lost sales (*e.g.*, if the excluding firms refuse to deal with buyers that deal with a rival).<sup>184</sup>

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<sup>179</sup> If the exclusionary conduct is undertaken by a dominant firm, for example, and the dominant firm excludes all significant fringe rivals (those that are not capacity-constrained or otherwise have a high cost of expansion) and entrants, the dominant firm would not face any competitive threats. This simple economic idea underlies the truncated legal rule governing exclusionary conduct discussed in Section II.B. The first three open questions about the rule governing truncated condemnation of exclusionary conduct suggest some ways of making this inference other than analyzing the consequences of excluding firm conduct for each actual and potential rival individually. *Supra* notes 108-17 and accompanying text.

<sup>180</sup> See generally Jonathan B. Baker, *Market Definition: An Analytical Overview*, 74 ANTITRUST L.J. 129, 169-73 (2007).

<sup>181</sup> This possibility underlies the fourth open question about the truncated legal rule governing exclusionary conduct. *Supra* notes 118-20 and accompanying text.

<sup>182</sup> Krattenmaker and Salop's notion of profitability includes an evaluation of efficiency justifications. Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L.J. 209, 277-82 (1986). The analysis of efficiency justifications is potentially an aspect of evaluating the profitability of the strategy, to the extent ancillary efficiencies reduce the costs and increase the benefits of exclusion. But efficiencies also matter to the analysis of allegedly anticompetitive exclusionary strategies as a possible means by which the excluding firms would justify otherwise harmful conduct. The truncated rule governing exclusionary conduct set forth in section IV.B requires the absence of a plausible efficiency justification, and efficiencies are considered as part of a comprehensive reasonableness analysis (as would be undertaken if the truncated rule does not apply).

<sup>183</sup> When predatory pricing is the exclusionary instrument, this problem is termed "recoupment" because the excluding firms bear the cost of exclusion before they earn the rewards. The prospects for profitability may be challenging to demonstrate in a case that is brought after the excluding firms have incurred costs of exclusion but before the profits they may earn can be observed, as may occur with predatory pricing, but may be easier to evaluate when the profits from exclusion arise coincident with the costs, as in many non-price exclusion settings.

<sup>184</sup> The costs may also include any expense associated with solving "cartel problems"

The cost of exclusion, and thus the profitability of anticompetitive exclusionary conduct, depends upon the nature and scope of the method used to exclude.<sup>185</sup> Exclusionary strategies need not be expensive.<sup>186</sup> A dominant firm's unilateral refusal to deal with suppliers that also supply an entrant or fringe rival, for example, may not be costly if few or no suppliers defect to dealing with the rival.<sup>187</sup> Exclusionary conduct with a strategic component, as with commitment to tough competition or the purchase of an exclusionary right, may require a more complex analysis of profitability than needed to evaluate conduct involving direct harm to rivals or harm through passive decisions. Even when it is expensive for the excluding firms to foreclose their excluded rivals, the prospective monopoly profits the excluding firms obtain from successfully obtaining or protecting market power may be great enough to make the expenditure worthwhile.<sup>188</sup>

### *B. Profitability of Purchasing an Exclusionary Right*

The recent economics literature on exclusionary conduct has paid particular attention to identifying conditions under which one particular exclusionary method, the purchase of an exclusionary right, would be profitable for the excluding firms – thus explaining how the excluding firms solve the third “exclusion problem” using this exclusionary strategy.<sup>189</sup>

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if multiple excluding firms must coordinate in order to exclude rivals or raise price once that exclusion has occurred. Ancillary benefits to the excluding firms of pursuing exclusionary conduct, such as efficiencies, could reduce the net costs of implementing the method of exclusion.

<sup>185</sup> When exclusion is coordinated, moreover, the costs and benefits of exclusion can differ among the excluding firms. See Jonathan B. Baker, *Predatory Pricing After Brooke Group: An Economic Perspective*, 62 ANTITRUST L.J. 585, 601-02 (1994) (one firm may have borne a disproportionate fraction of the costs and earned the bulk of the benefits of an alleged predatory pricing conspiracy among cigarette manufacturers).

<sup>186</sup> See generally Susan A. Creighton, D. Bruce Hoffman, Thomas G. Krattenmaker & Ernest A. Nagata, *Cheap Exclusion*, 72 ANTITRUST L.J. 975 (2005).

<sup>187</sup> See, e.g., *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951).

<sup>188</sup> Cf. Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L.J. 209, 273-77 (1986) (the rivals that benefit from an involuntary cartel may find it necessary to share their monopoly profits with sophisticated input suppliers).

<sup>189</sup> Other exclusionary methods, not discussed in detail here, may resemble the purchase of an exclusionary right because they may also involve contracts or understandings between the excluding firm and sellers of complements. These may include “most favored nations” (MFN, or “most favored customer”) clauses, which can be employed by dominant firms to ensure that fringe rivals and entrants cannot lower their costs by obtaining lower prices from sellers of complements, and bundled (or loyalty) discounts (or rebates) offered by manufacturers to dealers. To the extent these methods operate like the purchase of an exclusionary right, the economic analysis in the text is

Because this literature is not well known in the antitrust context,<sup>190</sup> because the analysis is complicated by the need to account for the interaction between the excluding firms and the vertically-related firms (or other sellers of complements) that agree not to deal with the excluded firms or otherwise foreclose them, and because the purchase of an exclusionary right is an important category of exclusionary strategies, these profitability conditions will be described in some detail.

The analysis below follows the economics literature in assuming that a dominant firm is engaged in the exclusionary conduct, thus putting aside the possibility of multiple excluding firms. Suppose, for example, that a hypothetical dominant soft drink producer – a hypothetical Coke that has acquired Pepsi – seeks to create an involuntary cartel by excluding RC, a potential entrant, through the purchase of an exclusionary right. Coke may do so in at least two ways: by paying bottlers for exclusivity (that is, paying bottlers not to bottle RC's soft drinks), or by paying supermarkets for prime shelf space (that is, paying supermarkets not to display RC's products prominently).<sup>191</sup> These exclusionary tactics may raise RC's marginal costs directly,<sup>192</sup> or reduce RC's post-entry profitability by

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likely relevant to understanding their competitive implications. (In other settings, though these practices may harm competition through means other than exclusion (including facilitating collusion, dampening competition, or facilitating anticompetitive price discrimination), or they may permit firms to achieve efficiencies.) Under some circumstances, moreover, resale price maintenance agreements may exclude in a manner similar to the purchase of an exclusionary right. John Asker & Heski Bar-Isaac, *Exclusionary Minimum Resale Price Maintenance* (NYU Working Paper, 2011) *available at* <http://ssrn.com/abstract=1911714> (a resale price maintenance agreement between a dominant manufacturer and its dealers can deter entry in manufacturing by providing a mechanism by which the manufacturer shares profits from its upstream monopoly with the dealers, thereby giving the dealers an incentive not to cooperate with the entrant),

<sup>190</sup> *But see* MICHAEL D. WHINSTON, LECTURES ON ANTITRUST ECONOMICS 133-97 (2006) (surveying the economic literature on exclusionary vertical contracts, with attention to antitrust applications).

<sup>191</sup> Both methods could be thought of as input foreclosure strategies (with bottling as an input for production and shelf space as an input for distribution). Both could also be viewed as customer foreclosure strategies (to the extent prime shelf space helps attract customers or distribution by bottlers is needed to service end of aisle displays in supermarkets, which attract customers).

<sup>192</sup> For example, exclusive contracting with bottlers could raise RC's costs of distribution (in the event RC enters) by taking away the most cost-effective bottlers. If RC nevertheless finds a few bottlers willing to distribute its products, moreover, those bottlers may need to ship RC greater distances than the dominant firm ships its soft drinks. Limiting RC's access to bottlers could also prevent RC from reaching sufficient scale to cover its fixed costs or, if marginal cost declines with output, from obtaining sufficiently low marginal costs to permit it to sell profitably at a price low enough to compete with Coke. Exclusive contracts between Coke and the bottlers could also raise the sunk entry investments RC must make by forcing RC to outbid the dominant firm in order to obtain

increasing the threat of post-entry competition.<sup>193</sup> In the latter case they could still be understood as an exemplifying exclusion undertaken through the purchase of an exclusionary right, but they could also be viewed as falling into the third category of exclusionary methods in the typology of section II.A, as a commitment to tough competition.

The purchase of an exclusionary right may be costly for the dominant firm, as Coke must convince the bottlers or supermarkets not to deal with RC, seemingly against their financial interest.<sup>194</sup> The profitability of these methods of exclusion also turns on strategic considerations: the views of the bottlers and supermarkets as to RC's prospect for success and as to the related ability of RC to outbid Coke in order to obtain bottling or attractive shelf space.<sup>195</sup> These strategic considerations differentiate the purchase of an exclusionary right from other methods of exclusion that also constrain rivals' conduct.

To illustrate, suppose that the excluding firm adopts an input foreclosure strategy. In particular, assume that a hypothetical dominant soft drink producer, Coke, is negotiating with bottlers to exclude RC, while RC is bargaining with the same firms to obtain bottling. In this setting, four factors help determine whether the dominant firm or RC has the upper hand in negotiating with the bottlers – in Coke's case, bargaining with bottlers for exclusivity and in RC's case negotiating with bottlers for a distribution relationship – and thus whether the exclusionary strategy will be profitable for Coke.<sup>196</sup>

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bottling.

<sup>193</sup> For example, if the dominant firm contracts with bottlers for exclusive distribution, or if it contracts with supermarkets for prime shelf space, those relationships may give the dominant firm a greater ability to cut prices and expand output should RC enter than it would otherwise have possessed.

<sup>194</sup> The dominant firm's success in excluding RC would be expected to reduce the aggregate level of soft drink bottling or supermarket sales relative to what would obtain if RC were to enter successfully and create more soft drink industry competition. Fewer soft drinks would be bottled and sold in aggregate, so the typical bottler or supermarket may expect the anticompetitive exclusion of RC to reduce its sales. More generally, an involuntary cartel will reduce output in order to raise price, thereby also reducing sales of complementary products. Sellers of complements would, in consequence, generally not benefit from the involuntary cartel unless the excluding firms pay them for their help in foreclosing the excluded rivals by purchasing an exclusionary right.

<sup>195</sup> If a bottler or supermarket expects RC's entry effort to succeed, then the bottler or supermarket may view dealing with RC as an attractive alternative to agreeing to exclusivity with the dominant firm. The better the bottler or supermarket's alternative to contracting with the dominant firm, the more the dominant firm would have to offer to convince it to sell an exclusionary right, and the greater the likelihood that this form of exclusionary conduct would not be profitable for the dominant firm.

<sup>196</sup> For expositional convenience, the discussion of one factor will make the alternative assumption that Coke seeks to prevent entry by RC through contracting with supermarkets



One factor is the relative profitability of success to Coke and RC. If Coke succeeds in its anticompetitive scheme (that is, if RC's entry attempt fails), Coke would earn monopoly profits – giving Coke the funds it needs to compensate the bottlers for excluding RC.<sup>197</sup> If RC avoids exclusion and its entry attempt succeeds, the profits it earns would give it the resources it needs to compensate the bottlers for declining Coke's offer to pay for exclusivity. RC's profits following entry may be small – after all, if RC avoids exclusion, it would still have to compete with the dominant firm.<sup>198</sup> But RC's profits after successful entry could be large if it would be a more efficient producer than the excluding firms,<sup>199</sup> if it can offer an attractive new or improved product, or if it would reasonably expect that the dominant firm would not compete aggressively in the event RC avoids exclusion.<sup>200</sup> Accordingly, if one firm, whether Coke or RC, anticipates greater profits if its strategy succeeds, so has a substantial advantage in financing payments to the bottlers while the other does not, that firm may be able to outbid the

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for exclusivity.

<sup>197</sup> Cf. *JTC Petroleum Co. v. Piasa Motor Fuels, Inc.*, 190 F.3d 775, 778 (7th Cir. 1999) (Posner, C.J.) (“If by refusing to sell to mavericks the [suppliers] increase the profits of the [downstream] cartel, they create a fund out of which the cartel can compensate them, in the form of a higher price for the purchase of the product, for their services to the cartel.”). Coke's payments to the bottlers have the effect of sharing the monopoly profits Coke earns from successful collusion with the bottlers. In consequence, the bottlers can profit from the exclusionary conduct while soft drink consumers are harmed. See Timothy J. Brennan, *Getting Exclusion Cases Right: Intel and Beyond*, CPI ANTITRUST CHRONICLE 5-7, December 2011 (1), available at, <https://www.competitionpolicyinternational.com/dec-11> (exclusionary conduct that operates by suppressing competition in the market for a complementary product can profit firms selling complements).

<sup>198</sup> The excluding firms can spend some of their anticipated monopoly profits on the means of securing their involuntary cartel, while similar funds may be unavailable to excluded firms. After all, if excluded firms succeed in avoiding the foreclosure efforts of the excluding firms, that success would likely mean that the excluded firm would earn competitive profits (or at least more competitive profits), not monopoly profits.

<sup>199</sup> RC may have an efficient production technology or business model that would permit it to have lower marginal costs than Coke if it is able to establish itself as a market participant. If so, RC could reasonably anticipate that its success in entering would give it the resources it needs to outbid Coke for bottler services.

<sup>200</sup> Cf. Chiara Fumagalli & Massimo Motta, *Exclusive Dealing and Entry When Buyers Compete*, 96 AM. ECON. REV. 785 (2006) (if a successful entrant would be likely to take a substantial fraction of the market from the dominant incumbent, distributors may see greater benefit in dealing with the entrant than they would if the entrant's prospects were more limited). The extent of post-entry competition between a hypothetical dominant soft drink producer and RC may depend on structural factors similar to those relevant to assessing cartel stability. See generally ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, *ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY* 240–45 (2d ed. 2008).

other firm when negotiating with bottlers.<sup>201</sup>

A second factor affecting whether it would be profitable for Coke to purchase an exclusionary right is Coke's ability to limit the scope and cost of its investments in exclusion through careful targeting.<sup>202</sup> Suppose (changing one aspect of the ongoing example), that Coke plans to exclude RC by contracting for exclusivity with supermarkets rather than by contracting with bottlers. Using this method, Coke may be able to raise RC's promotion costs sufficiently to exclude RC through contractual arrangements short of insisting that supermarkets deny RC access to their shelves. It may be enough, for example, if Coke obtains the exclusive right to promote soft drinks through end of aisle displays and week-long manufacturer-funded price reductions; if so, Coke may be able to exclude RC on the cheap – making it more likely that Coke will succeed in prevent RC's entry.<sup>203</sup> Or Coke may be able to deter entry by RC simply by negotiating an agreement with the supermarkets by which Coke commits to match any promotional effort by RC, funding comparable price reductions and end of aisle displays to appear simultaneously with RC's promotions.<sup>204</sup>

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<sup>201</sup> Even if RC has substantial financial resources, however, its ability to convince bottlers to distribute its products will also depend on the extent to which an individual RC bottler would expect to share in the profits from RC entry. The more that competition among RC's bottlers would be expected to dissipate RC bottlers' profits, the less interest a bottler would have in facilitating RC's entry by distributing RC. Hence, if the bottlers expect that RC will allow aggressive competition among those bottlers that distribute for it, each bottler may see little profit to be gained from choosing to bottle for RC rather than accepting Coke's request for exclusivity. MICHAEL D. WHINSTON, LECTURES ON ANTITRUST ECONOMICS 148–49 (2006); John Simpson & Abraham L. Wickelgren, *Naked Exclusion, Efficient Breach, and Downstream Competition*, 97 AM. ECON. REV. 1305 (2007).

<sup>202</sup> See Claudia M. Landeo & Kathryn E. Spier, *Naked Exclusion: An Experimental Study of Contracts with Externalities*, 99 AM. ECON. REV. 1850 (2009) (discrimination by incumbent seller facilitates exclusion); Patrick DeGraba, *Naked Exclusion by a Dominant Supplier: Exclusive Contracting and Loyalty Discounts* (FTC, Working Paper No. 306, 2010) available at <http://www.ftc.gov/be/workpapers/wp306.pdf> (a dominant input supplier can prevent a smaller rival from expanding by using exclusive contracts and price discriminating based on an end user's likelihood of purchasing products made with the rival's input).

<sup>203</sup> To similar effect, Alcoa apparently targeted entry by rival aluminum producers by contracting with hydroelectric power producers to prevent the generators from supplying electricity to other aluminum manufacturers. The contracts were targeted because they did not preclude the power producers from selling electricity to firms producing other products. See *United States v. Aluminum Co. of America*, 148 F.2d 416, 422 (2d Cir. 1945) (Alcoa) (describing agreements addressed in a 1912 government antitrust enforcement action).

<sup>204</sup> More broadly, if an excluding firm can commit to match any price reduction that an excluded firm offers with a comparably low price, and can target that commitment so that it only cuts price to those customers solicited by the excluded firm, the excluding firm may be able to undermine the profitability of entry inexpensively, and in doing so reinforce the

Targeting may also be possible in the example in which Coke seeks to prevent entry by RC through exclusive contracts with bottlers: Coke may be able to deter RC at limited cost by contracting only with bottlers that have substantial excess capacity, if those bottlers are the most likely to accept a solicitation from RC.

The number of bottlers that RC must enlist for success also affects the profitability of Coke's strategy to prevent entry by contracting for bottler exclusivity, though the significance of this factor turns importantly on the extent to which each bottler's decision whether or not to distribute RC will affect other bottlers' decisions. Bottler decisions may be interdependent, as each bottler's agreement to distribute RC may make it more likely that RC will convince enough other bottlers to distribute RC as well, and in consequence make it more valuable for each undecided bottler to agree to distribute RC.<sup>205</sup> Under such circumstances, each bottler's decision may depend on the bottler's expectations about RC's prospects for success in signing up other bottlers. Each bottler would recognize that if RC's entry effort is unlikely to succeed, it would do better by contracting for exclusivity with Coke – even if it gets little or nothing for doing so – than by contracting with RC.<sup>206</sup> The critical role of bottler expectations in

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entry-detering consequences of its commitment by making that commitment credible. But if the incumbent firm cannot commit to limited targeting in response to entry, and must fight the entrant with an (expensive) across-the-board price reduction, then the incumbent may not have a credible price-cutting strategy for deterring entry. Cf. MICHAEL E. PORTER, *COMPETITIVE ADVANTAGE* 500-01, 511 (1985) (recommending “plac[ing] potential challengers at a relative cost disadvantage” by “targeting” price cuts on “products that are likely initial purchases by new buyers” or by “localizing” the response to rival price cutting “to particularly vulnerable buyers” rather than across-the board to reduce the cost of the response); BRUCE GREENWALD & JUDD KAHN, *COMPETITION DEMYSTIFIED* 231 (2005) (recommending that an incumbent respond to entry by “punish[ing] the newcomer as severely as possible at the lowest possible cost to itself”); *but cf.* Judith R. Gelman & Steven C. Salop, *Judo Economics: Capacity Limitation and Coupon Competition*, 14 *Bell J. Econ.* 315, 316 n.2 (1983) (even small sunk expenditures may be sufficient to prevent entry by serving as a credible commitment to post-entry competition across-the-board). The author is grateful to Aaron Edlin for sharing his insights into the exclusionary potential of price-matching by incumbent firms.

<sup>205</sup> This discussion presumes, consistent with an assumption commonly adopted in the economics literature, that a bottler's decision to distribute RC confers a positive externality on other bottlers, as by making it more likely that RC's entry would succeed. That assumption may not always hold, however. In some settings, the decision by one bottler to distribute RC would instead be expected to reduce the sales and profits available to nearby bottlers, conferring a negative externality that lessens the second bottler's gains from distributing RC.

<sup>206</sup> If RC needs multiple bottlers to survive but each bottler thinks the other bottlers will accept an exclusive deal with Coke, no bottler will break ranks to deal with RC even if Coke pays nothing. After all, a bottler that expects RC's entry attempt to fail would not want to ruin its relationship with Coke by contracting with RC. See Eric B. Rasmussen, J.

this dynamic means that the greater the number of bottlers that RC needs in order to reach a viable scale, the less likely that any individual bottler will expect RC to succeed and, thus, the more likely that each bottler will agree to distribute Coke exclusively.<sup>207</sup>

The relative ability of Coke and RC to make credible commitments to the bottlers constitutes a fourth factor affecting the profitability of Coke's exclusion strategy. In particular, Coke's bargaining position in seeking bottler exclusivity will be improved if it can commit to cut off bottlers that distribute RC – and to follow through regardless of whether RC's entry turns out to be successful.<sup>208</sup> If Coke can convince the bottlers that they must choose between it and RC, the bottlers may prefer to bottle soft drinks for Coke, which has a large market share, rather than bottling for RC, which has uncertain prospects for success – even if Coke offers the bottlers little or nothing in payment for exclusivity. But if the bottlers think that in the event RC succeeds and they choose to bottle for RC, Coke would prefer not to cut them off, then Coke will have to pay more for exclusivity, possibly making it uneconomic for Coke to employ this strategy for deterring RC's entry.

On the other hand, if RC can commit to limited entry, it may be able to avoid provoking a response from Coke.<sup>209</sup> Suppose, for example, that RC adopts a strategy of entering with canned soft drinks, not bottled, or a strategy of distributing its product through drug stores, not supermarkets. If Coke reasonably believes that RC will not seek to expand to bottled products or supermarket distribution and thus not threaten most of Coke's business, Coke may conclude that it is less costly to go along rather than spend what would be required to prevent RC from succeeding. Under such circumstances, entry by RC would succeed, though that entry would be limited.

These four factors affect whether it would be profitable for Coke to prevent entry by RC through contracting for bottler exclusivity. Coke would face an additional difficulty if it seeks to convince the bottlers to exclude RC through a tacit understanding rather than through a contract.

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Mark Ramseyer & John S. Wiley, Jr., *Naked Exclusion*, 76 AM. ECON. REV. 921 (1986). Although the pure "naked exclusion" model has two equilibria, one in which all bottlers agree to exclusivity to Coke and one in which none do so, the exclusion equilibrium dominates if Coke can convince even a small number of bottlers not to bottle for RC.

<sup>207</sup> Eric B. Rasmussen, J. Mark Ramseyer & John S. Wiley, Jr., *Naked Exclusion*, 76 AM. ECON. REV. 921 (1986); Ilya R. Segal & Michael D. Whinston, *Naked Exclusion: Comment*, 90 AM. ECON. REV. 296 (2000).

<sup>208</sup> Cf. Steven C. Salop & R. Craig Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft*, 7 GEO. MASON L. REV. 617, 640–42 (1999) (discussing credibility of predatory threats by a dominant firm).

<sup>209</sup> Judith R. Gelman & Steven C. Salop, *Judo Economics: Capacity Limitation and Coupon Competition*, 14 Bell J. Econ. 315 (1983).

Coke could not profitably subsidize the bottlers as an implicit quid pro quo for exclusivity, perhaps by paying generously for bottling services, if the bottlers would take the payment without remaining exclusive to Coke, and instead also start bottling for RC. The bottlers may still stick with Coke, however, if they fear that Coke would respond by cutting off the bottlers from Coke products, and if that cost would be substantial.<sup>210</sup>

These factors were considered by the Seventh Circuit, most implicitly, in evaluating the plausibility of an alleged bid-rigging scheme in which the defendant producers were said to have purchased an exclusionary right.<sup>211</sup> Under the alleged scheme, the producers contracted with suppliers of a key input to refuse to sell that input to JTC and other maverick rivals that otherwise would have cheated on the cartel. In overruling the district court's award of summary judgment to defendants, Chief Judge Posner addressed the first factor by explaining that the cartel profits could have given the producers a fund with which to compensate the input suppliers.<sup>212</sup> The second factor was addressed implicitly, as the alleged exclusionary conduct targeted only the maverick producers such as plaintiff JTC.

The opinion did not explicitly consider the third factor, whether the cartel's ability to convince the suppliers to exclude JTC and other maverick producers would be defeated by suppliers that prefer to be mavericks themselves, on the expectation that the cartel would not succeed so they would profit more by selling to the maverick than accepting payment from the cartel not to do so. But it implicitly did so by providing three possible reasons why no supplier would act against the cartel's wishes that way (notwithstanding the small number of suppliers – a factor that could tend to make breaking ranks profitable): the cartel might be able to coerce the suppliers by threatening to exercise monopsony power, the cartel's payments to the suppliers may have been too large to resist, and the suppliers themselves may have colluded (as plaintiffs had alleged) so each supplier's individual decision not to sell to the maverick producers may also

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<sup>210</sup> Regardless of whether Coke's understanding with the bottlers is express or tacit, moreover, Coke may be able to improve its odds of success if it can supplement its efforts to convince the bottlers not to deal with RC with exclusionary strategies that do not involve exclusive bottling, such as paying supermarkets for the best shelf space or refusing to deal with supermarkets that carry RC.

<sup>211</sup> *JTC Petroleum Co. v. Piasa Motor Fuels, Inc.*, 190 F.3d 775 (7th Cir. 1999) (Posner, C.J.). The terminology employed here highlights the vertical structure of the exclusionary contracts but it may be confusing to a reader familiar with the opinion. In the opinion, the firms described here as producers are termed "applicators" (they are road contractors), and the firms described here as suppliers are termed "producers" (because they produce asphalt for use by the applicators).

<sup>212</sup> *Id.* at 778. There was no suggestion that the excluded firm would have higher profits in a competitive market than the alleged cartelists would have obtained through successful bid-rigging.

have been supported by the threat of punishments from the other suppliers.<sup>213</sup> The court also did not explicitly consider the fourth factor, but it implicitly addressed the credibility of cartel threats not to purchase from suppliers that sell to JTC and other maverick producers by suggesting the possibility that the colluding producers had coerced the suppliers.

The extended discussion of factors affecting the profitability of exclusion through purchase of an exclusionary right highlights differences between the analysis required to assess the ability of firms to solve their exclusion problems (means, sufficiency, and profitability) and the analysis required to determine whether firms can solve their cartel problems (reaching consensus, deterring deviation, and preventing new competition). The mechanisms by which firms achieve an involuntary cartel and a voluntary one differ. But as will be seen in the next subsection, the legal rules governing structured review of alleged exclusionary and collusive conduct, limit the factors that a court must consider before truncated condemnation in analogous ways – providing additional support for the conclusion that antitrust doctrine treats anticompetitive exclusion and anticompetitive collusion as comparably serious offenses.

### *C. Exclusion Problems and Truncated Reasonableness Review*

The structured rules that permit condemnation of exclusionary or collusive, described above in section II.B, rely in part on limited factual showings to prove harm to competition; this was the second element of each approach.<sup>214</sup> In the collusion context, plaintiff may rely on facial analysis or categorization of the agreement (as price-fixing or market division), or on actual effects evidence.<sup>215</sup> In the exclusion context, plaintiff may rely on evidence that all actual or potential rivals other than insignificant competitors have been excluded, and some of the open questions ask whether other limited forms of proof (such as actual effects evidence) could be sufficient instead.<sup>216</sup>

The two truncated rules limit the detail with which competitive effects are analyzed. They may make it unnecessary to examine whether defendant can or did solve each exclusion problem (in an exclusionary effects case) or each cartel problem (in a collusive effects case), as would be relevant when

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<sup>213</sup> *Id.* at 777-79.

<sup>214</sup> Before inferring harm to competition from these facts, courts also look for the absence of a plausible efficiency justification for the exclusionary conduct or collusive arrangement at issue.

<sup>215</sup> *Supra* notes 82-84 and accompanying text.

<sup>216</sup> *Supra* notes 95-120 and accompanying text.

evaluating the conduct under the comprehensive rule of reason.<sup>217</sup> Those analyses may be relevant regardless of whether the review is prospective or retrospective; in the latter case, it is possible to imagine a court finding strong evidence that the firms could not achieve adverse competitive effects more compelling than weak evidence of actual adverse effects, for example.

The truncated condemnation rule for exclusionary conduct infers harm to competition from evidence that all actual or potential rivals other than insignificant competitors have been excluded through conduct lacking plausible efficiency justification. If these facts can be demonstrated, the conduct can be found to harm competition by presuming (or inferring) the profitability of the exclusionary method without specifically analyzing it. Two of the open questions – the possibility that proof of excluding firm market power may permit the inference that all rivals are or likely would be excluded from evidence that one has been excluded, and the possibility that harm to competition could be shown through actual effects evidence in a retrospective exclusion case – raise the possibility of presuming (or inferring) sufficiency, again without specifically analyzing it.

The import of truncation in the antitrust review of alleged anticompetitive exclusion can be illustrated using the soft drink example. Suppose that RC accuses Coke of harming competition by contracting with many supermarket chains for the exclusive right to promote soft drinks through end of aisle displays and week-long manufacturer-funded price reductions.<sup>218</sup> A comprehensive reasonableness analysis of those

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<sup>217</sup> See, e.g., *United States v. Visa*, 344 F.3d 229 (2d Cir. 2003) (explicitly analyzing the method of exclusion and its sufficiency, and implicitly analyzing its profitability by recognizing that it protected excluding firm market power from erosion). A wide range of other evidence could be relevant to determining under the comprehensive rule of reason whether defendants in an exclusionary conduct have solved their exclusion problems. For example, the availability of potential alternative sources of distribution to an excluded manufacturer may bear on whether the plaintiff was substantially or insignificantly excluded, as may the duration and costs of terminating the exclusivity agreements that limit the excluded firm's access to customers. The percentage of the market foreclosed to the excluded firm by the conduct at issue may be relevant to assessing the sufficiency of the alleged exclusionary acts to create harm to competition. E.g., *Omega Env'tl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157 (9th Cir. 1997); cf. *NicSand, Inc. v. 3M Co.*, 507 F.3d 442 (6<sup>th</sup> Cir. 2007) (excluded rival challenging dominant manufacturer's multi-year distribution contracts with all major retailers lacked antitrust injury when the excluded rival was formerly dominant, previously had exclusive distribution arrangements with most of the leading retailers, and had an equal opportunity to compete for exclusivity with the new dominant firm). The focus on "coercion" by the excluding firm in a recent appellate decision can be understood either as an aspect of the inquiry into whether the plaintiff has alternatives for avoiding exclusion (an inquiry into "method") or as an aspect of an inquiry into whether the defendant had a legitimate business justification for the practice. *Race Tires America, Inc. v. Hoosier Racing Tire Corp.*, 614 F.3d 57, 77-79 (3d Cir. 2010).

<sup>218</sup> For the purpose of explicating reasonableness analysis, it is immaterial whether the

agreements would likely ask a wide range of questions, such as the following: Did these contracts in fact exclude RC?<sup>219</sup> Did the limitations make much difference to RC's ability to promote and sell its products at the supermarkets? Were other significant rivals, actual or potential, also excluded? Was the exclusion of those rivals sufficient to confer (possibly additional) market power on the excluding firm or allow it to maintain pre-existing market power?<sup>220</sup> Did the price Coke paid the supermarkets for the rights it obtained exceed the likely gains from the exercise of market power? Did the exclusionary conduct confer efficiencies, as by allowing Coke to promote its products more effectively?<sup>221</sup> After accounting for any efficiencies, were consumers harmed?

A truncated reasonableness analysis of the same agreements between Coke and supermarkets, consistent with how courts often approach exclusionary conduct, could infer harm to competition with less evidence: from proving that Coke excluded RC, a significant rival; that Coke has excluded all other significant rivals (if any); and that the exclusivity agreements had no plausible efficiency justification. This approach makes it unnecessary for RC to proffer evidence that Coke solved one of the exclusion problems, profitability; profitability is presumed or inferred. In addition, and depending on the resolution of the open questions, truncation could also simplify the showing RC must make to prove that Coke solved

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conduct is challenged by the government or an excluded firm, or whether the case is brought under Sherman Act §1 (as a vertical agreement), Sherman Act §2 (as monopolization or an attempt to monopolize), Clayton Act §3 (as exclusive dealing), or FTC Act §5. Cf. HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* §10.9 (4th ed. 2011) (exclusive dealing has been condemned under several statutes).

<sup>219</sup> For example, could RC reach customers as easily through convenience stores? Cf. *United States v. Microsoft Corp.*, 253 F.3d 34, 70-71 (D.C. Cir. 2001) (exclusionary conduct did not extend to less effective means of distribution).

<sup>220</sup> If some significant rivals were not excluded, and those firms have the ability and incentive to compete away the exercise of excluding firm market power, the limited exclusion would not be sufficient to confer market power on the excluding firms.

<sup>221</sup> John Woodbury suggests that the retailers could pass through to consumers the payments they receive in exchange for excluding RC in the form of more or larger stores. John Woodbury, *Paper Trail: Working Papers and Recent Scholarship*, ANTITRUST SOURCE, 5 n. 11, Apr. 2012, available at [http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/apr12\\_papertrail\\_4\\_26f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/apr12_papertrail_4_26f.authcheckdam.pdf) (comment on working paper predecessor to this article). Such efficiencies, if demonstrated, could largely benefit consumers of products other than soft drinks, and, in consequence, may not be cognizable legally. Even if they would count, their (net) magnitude would turn on the extent to which the incremental revenues from selling an exclusionary right were used to benefit supermarket consumers rather than shareholders – and the extent to which the lost revenues to Coke harms consumers, as by reducing Coke's promotions of soft drinks or non-soft drink products.



another problem, sufficiency. For example, if Coke obviously has a dominant position regardless of which market is defined among the plausible alternatives, it may not be necessary for the plaintiff identify every rival and show that it was excluded in fact, that it likely would be excluded if not yet foreclosed,<sup>222</sup> or that it is not excluded but insignificant (unable to undermine the possible exercise of market power through price cutting and output expansion).

Whether exclusion or collusion is alleged, truncation of the reasonableness review means that adverse competitive effects can be inferred without showing why the anticompetitive mechanism worked – why it was profitable in both settings, perhaps why the method was sufficient in an exclusion case, and how the firms deterred cheating and prevented new competition in a collusion case. The specific methods by which firms exercise market power differ across the settings, but the burden on plaintiff is reduced in a similar way in each. Again the formal structure of the truncated doctrinal rule does not treat exclusion differently from collusion.

#### V. POLICY CONSIDERATIONS DO NOT JUSTIFY DOWNPLAYING EXCLUSION

Although the rhetorical consensus for treating exclusion as a lesser offense is commonly asserted without explicit justification, it has been defended in the form of claims that false positives (convictions) are more likely or more costly for exclusionary violations than for collusive ones, while false negatives (acquittals) are less likely or less costly for exclusion than collusion.<sup>223</sup> This framing adopts an “error cost” perspective to evaluate antitrust rules, in which the best rule minimizes total social costs.<sup>224</sup> This general approach toward evaluating legal rules has been

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<sup>222</sup> Under the comprehensive rule of reason, the analysis of whether other rivals likely would be excluded could turn on the profitability of the exclusionary strategy to Coke. If so, the inference could be understood as making it unnecessary for plaintiff to prove two exclusion problems: sufficiency as well as profitability.

<sup>223</sup> E.g., Keith N. Hylton, *The Law and Economics of Monopolization Standards*, in ANTITRUST LAW AND ECONOMICS 82, 102 (Keith N. Hylton, ed. 2010).

<sup>224</sup> The relevant social costs are commonly described as the costs of false positives and false negatives, along with the transactions costs associated with the use of the legal process. See U.S. DEP’T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 15-18 (2008), *available at* <http://www.justice.gov/atr/public/reports/236681.pdf>, *withdrawn*, [http://www.usdoj.gov/atr/public/press\\_releases/2009/245710.htm](http://www.usdoj.gov/atr/public/press_releases/2009/245710.htm) (endorsing error cost framework for the evaluation of section 2 standards). Transactions costs include more than the costs of litigation; they also include costs associated with information-gathering by the institution specifying decision rules. C. Frederick Beckner III & Steven C. Salop, *Decision*

employed by the Supreme Court in recent antitrust decisions.<sup>225</sup>

In antitrust applications, the costs to society that need to be considered extend beyond litigation costs and the consequences of alternative decisions to the parties to a case; they also include the economy-wide benefits (negative costs) of deterring harmful conduct and costs of chilling beneficial conduct.<sup>226</sup> But it can be difficult to account for these economy-wide effects within the error cost framework.<sup>227</sup> Moreover, when deterrence and chilling effects are accounted for, substantive legal rules can properly be compared on the basis of their error costs only conditional on antitrust enforcement institutions such as rules governing burdens of proof,<sup>228</sup> which can vary in impact across doctrinal categories,<sup>229</sup> and non-

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*Theory and Antitrust Rules*, 67 ANTITRUST L.J. 41 (1999).

<sup>225</sup> *E.g.*, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007); (explaining that *per se* rules may “increase the total cost of the antitrust system” even when they “decrease administrative costs” if they “prohibit[] procompetitive conduct the antitrust laws should encourage” or “increase litigation costs by promoting frivolous suits against legitimate practices”) (overruling rule of *per se* illegality against vertical price restraints); *Verizon Commc’ns Inc. v. Trinko*, 540 U.S. 398, 408 (2004) (describing a need to be “very cautious” in finding an antitrust violation when a dominant firm unilaterally refuses to cooperate with a rival “because of the uncertain virtue of forced information sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm”); *id.* at 414 (expressing concern with the “cost of false positives” arising from the possibility that “generalist antitrust court” would need to enforce a complex statutory scheme in a dynamic industry). *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993) (stating that in predatory pricing cases, “the costs of an erroneous finding of liability are high,” because of the danger that false convictions would chill procompetitive price-cutting).

<sup>226</sup> *See, e.g.*, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993) (permitting predatory pricing enforcement based on above cost prices would create “intolerable risks of chilling legitimate price-cutting”); *Allied Orthopedic Appliances Inc. v. Tyco Health Care Group*, 592 F.3d 991, 1000 (9<sup>th</sup> Cir 2010) (courts should not find monopolization when the alleged exclusionary act is a (non-sham) product design improvement because of the danger of dampening technological innovation and the difficulty of weighing uncertain future benefits against current competitive harms). Deterrence considerations are particularly important in evaluating antitrust rules. *See generally* Jonathan B. Baker, *The Case for Antitrust Enforcement*, 17 J. ECON. PERSP. 27 (2003).

<sup>227</sup> False positives and false negatives may not neatly map to over- and under-deterrence, respectively, because the deterrence consequences of legal errors depend in part on the way the errors affect the marginal costs and benefits to firms of taking precautions to avoid violations. *See generally* Warren F. Schwartz, *Legal Error*, in *ENCYCLOPEDIA OF LAW AND ECONOMICS*, <http://encyclo.findlaw.com/0790book.pdf> (last visited Jan. 29, 2012).

<sup>228</sup> *See generally* Louis Kaplow, *Burden of Proof*, 121 YALE L. J. 738 (2012).

<sup>229</sup> *See* Stephen Calkins, *Summary Judgment, Motions to Dismiss, and Other Examples of Equilibrating Tendencies in the Antitrust System*, 74 GEO. L. J. 1065 (1986) (documenting the way the antitrust treble damages remedy has shaped substantive and

antitrust institutions, such as the scope of intellectual property rights.

Notwithstanding these conceptual and practical difficulties, this section will discuss antitrust rules in terms of the familiar categories of false positives and false negatives. In doing so, it will focus on today's rules, as the error costs of the rules that prevailed before antitrust's Chicago school revolution<sup>230</sup> are not useful for understanding the balance of error costs today.<sup>231</sup>

Given the parallels in the economic analysis of collusion and exclusion set forth above in section III, it would be difficult to sustain an argument that voluntary cartels are bad but involuntary cartels are good. Potentially collusive conduct, such as agreements among rivals, is not inherently more suspicious competitively than potentially exclusionary conduct, such as agreements for exclusive distribution or supply. Not surprisingly, a wide range of agreements among rivals – joint ventures, trade association activity, standard setting, and the like – are routinely permitted to proceed with negligible antitrust scrutiny, just as many exclusionary arrangements are routinely accepted.

The two leading and closely-related policy arguments offered for downplaying exclusion relative to collusion rely instead on arguments about the relative likelihood and magnitude of mistakes in the antitrust review of collusive conduct compared with exclusionary conduct. The first is the

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procedural antitrust law across doctrinal categories).

<sup>230</sup> Cf. Jonathan B. Baker, *Competition Policy as a Political Bargain*, 73 *Antitrust L.J.* 483, 519 (2006) (“Antitrust’s Chicago School revolution ... successful[ly] ... reorient[ed] antitrust doctrine to protect producers from enforcement practices and doctrinal rules that might discourage procompetitive business conduct”). The legal rules governing exclusion will likely evolve to clarify the open questions concerning truncation set forth in Section II.B, but they are unlikely to change to resemble the rules that applied before the courts reformed antitrust doctrine in response to Chicago school criticisms.

<sup>231</sup> For example, predatory pricing cannot be found today unless the predator's prices fall below some measure of the excluding firm's costs. *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). This predicate for liability lessens the prior concern of commentators associated with the Chicago school that permitting plaintiffs to bring antitrust claims arising from low prices would chill competition on price and thus create false positives. The below-cost pricing requirement also risks false negatives. Cf. *United States v. AMR Corp.*, 335 F.3d 1109 (10<sup>th</sup> Cir. 2003) (rejecting four methods of measuring cost proposed by the Department of Justice). Thus, an error cost analysis of predatory pricing rules would come out differently today than it would during antitrust's structural era, before the introduction of the below-cost pricing requirement. Cf. Aaron Edlin, *Predatory Pricing*, in *RESEARCH HANDBOOK ON THE ECONOMICS OF ANTITRUST LAW* (Einer Elhauge, ed. 2010) (surveying legal policy issues associated with predatory pricing from an economic point of view); Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 *GEO. L.J.* 2239 (2000) (same); Jonathan B. Baker, *Predatory Pricing After Brooke Group: An Economic Perspective*, 62 *ANTITRUST L.J.* 585 (1994) (same).

supposition that it is harder to tell apart harmful and beneficial conduct when exclusion is alleged, so enforcers and courts are more likely to make errors in that setting.<sup>232</sup> The second is the view that false positives are more dangerous when exclusion is alleged because they are more likely to chill beneficial conduct like price-cutting and new product introductions, so it is more important that enforcers and courts avoid errors in the exclusion setting.<sup>233</sup> If errors are more frequent and more costly to society when exclusionary conduct is alleged, this story goes, enforcers and courts should be more cautious in challenging such conduct.

Although the observation that the enforcement agencies challenge anticompetitive collusion more frequently than anticompetitive exclusion may seem to follow from this perspective,<sup>234</sup> or even vindicate it, there is actually no necessary relationship between the distribution of errors and their costs and the relative frequency of cases. Even if the allocation of agency cases provides a reliable guide to the relative frequency of the two

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<sup>232</sup> See Frank H. Easterbrook, *When is it Worthwhile to Use Courts to Search for Exclusionary Conduct?*, 2003 Colum Bus. L. Rev. 345, 345 (“competitive and exclusionary conduct look alike”); U.S. DEP’T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 13 (2008), available at <http://www.justice.gov/aatr/public/reports/236681.pdf>, *withdrawn*, [http://www.usdoj.gov/aatr/public/press\\_releases/2009/245710.htm](http://www.usdoj.gov/aatr/public/press_releases/2009/245710.htm) (“often the *same conduct* can both generate efficiencies and exclude competitors”).

<sup>233</sup> Frank H. Easterbrook, *When is it Worthwhile to Use Courts to Search for Exclusionary Conduct?*, 2003 Colum Bus. L. Rev. 345, 347.

<sup>234</sup> Cf. U.S. DEP’T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT 5, 8 (2008), available at <http://www.justice.gov/aatr/public/reports/236681.pdf>, *withdrawn*, [http://www.usdoj.gov/aatr/public/press\\_releases/2009/245710.htm](http://www.usdoj.gov/aatr/public/press_releases/2009/245710.htm) (relying on the U.S. experience applying Section 2 to derive broad principles). The frequency of anticompetitive collusion relative to harmful exclusion in court cases is also likely skewed toward collusion, even though the frequency of court cases is likely driven by private litigation rather than agency enforcement actions. Private attorneys general face a similar cost-benefit calculus as the agencies in allocating their resources and many private cases are follow-ons to government investigations. A study of the private treble damages cases filed between 1973 and 1983 in five districts found substantially more raised horizontal allegations (which tend to involve collusive conduct) than vertical allegations (which more often involve exclusionary conduct). Steven C. Salop & Lawrence J. Wright, *Treble Damages Reform: Implications of the Georgetown Project*, 55 *Antitrust L.J.* 73, 74 (1986) (finding that 52.8 percent of cases incorporated vertical allegations while 71.6 percent incorporated horizontal allegations). Many cases included both horizontal and vertical claims, consistent with the possibility that exclusionary conduct was part of a collusive scheme (as can be the case even when the plaintiff is a rival). *E.g.*, *JTC Petroleum Co. v. Piasa Motor Fuels, Inc.*, 190 F.3d 775 (7th Cir. 1999). These statistics were not driven by cases brought by stand-alone competitors, as they accounted for only 22.9% of the filings in the sample. *Id.* The explanations and implications of the disparity in agency cases, discussed below, would also likely apply to the interpretation of the relative frequency of private cases.

types of competitive problems, the observed enforcement pattern does not mean that errors in resolving antitrust allegations, whether false positives or false negatives, are either more frequent or more costly in exclusion settings. In order to evaluate the relative frequency and magnitude of errors, as will be done in turn, it is nevertheless useful to begin by examining why the agencies emphasize collusion over exclusion in case selection.

### 1. Relative Frequency of Errors

To begin with frequency, the connection between the relative number of collusion and exclusion challenges and the frequency of errors depends on why the agencies bring more collusion cases than exclusion cases. There are a number of possible explanations, including the following four. First, the agencies may bring more collusion cases because the antitrust laws have succeeded in deterring anticompetitive exclusion more effectively than in deterring anticompetitive collusion. This could have happened because collusion is more easily hidden from view, because exclusion can more easily or reliably be achieved through conduct that would not violate the antitrust laws (such as lobbying for governmentally-created entry barriers<sup>235</sup>), or because firms with an incentive to avoid antitrust liability can more easily prevent managers from harming competition through exclusion than from doing so through collusion.<sup>236</sup>

Second, the agencies may bring more collusion cases simply because they have chosen to direct the bulk of their investigative resources toward collusion rather than exclusion.<sup>237</sup> Since 1980, U.S. cases involving

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<sup>235</sup> See James C. Cooper, Paul A. Pautler & Todd J. Zywicki, *Theory and Practice of Competition Advocacy at the FTC*, 72 ANTITRUST L.J. 1091 (2005) (describing trends in the FTC's competition advocacy program, which questions proposed federal or state legislation and regulations that threaten to impede competition). The Federal Trade Commission has also emphasized the importance of construing the state action exemption to the antitrust laws narrowly in order to discourage the manipulation of regulatory processes for private rent-seeking. John T. Delacourt & Todd J. Zywicki, *The FTC and State Action: Evolving Views on the Proper Role of Government*, 72 ANTITRUST L.J. 1075 (2005).

<sup>236</sup> See William H. Page, *Optimal Antitrust Remedies: A Synthesis* 15-16 (Working Paper 2012), available at <http://ssrn.com/abstract=2061791>.

<sup>237</sup> Even if it were equally difficult to investigate and challenge exclusion and collusion, one would expect to see more collusion cases simply because the agencies direct more investigative resources in to that area. Cf. Susan A. Creighton, D. Bruce Hoffman, Thomas G. Krattenmaker & Ernest A. Nagata, *Cheap Exclusion*, 72 ANTITRUST L.J. 975 (2005) (recommending retargeting investigative resources toward the types of exclusionary conduct most likely to be observed, particularly inexpensive exclusionary acts that lack a plausible efficiency justification).

horizontal restraints, a collusion-oriented doctrinal category, have been brought with substantially greater frequency than cases in doctrinal categories where exclusion is more likely to be found (monopolization and vertical agreements).<sup>238</sup> The antitrust enforcement agencies may have channeled their enforcement efforts away from exclusionary conduct either for reasons of efficiency or reasons of principle. They may find it cost-effective to focus their efforts on anticompetitive conduct that lacks a plausible efficiency justification,<sup>239</sup> and when they do, they may discover that naked collusion is more common than plain exclusion.<sup>240</sup> Or the U.S. agencies may have chosen to target collusion cases because they believe collusion should have a higher priority than exclusion.<sup>241</sup>

Third, the relative counts of collusion and exclusion cases may overstate the relative frequency of collusion because of the way the cases

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<sup>238</sup> See generally William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 ANTITRUST L.J. 377 (2003). Including Robinson-Patman violations as an exclusion category would not change this conclusion.

<sup>239</sup> See Susan A. Creighton, D. Bruce Hoffman, Thomas G. Krattenmaker & Ernest A. Nagata, *Cheap Exclusion*, 72 ANTITRUST L.J. 975 (2005) (recommending that enforcers target cheap exclusion); cf. Harry First, *The Case for Antitrust Civil Penalties*, 76 ANTITRUST L.J. 127, 160-62 (2009) (recommending new remedial tools for attacking monopolization through conduct lacking an efficiency justification).

<sup>240</sup> Cf. Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L. J. 311, 361 (2002) (in the context of vertical exclusive dealing, exclusionary conduct lacking any plausible justification "appears unusually rare"). Even if plain exclusion is no less common than naked collusion, moreover, *antitrust cases* attacking plain exclusion may be less frequent if exclusionary conduct lacking any plausible business justification is commonly attacked under non-antitrust statutes. A. Douglas Melamed, *Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal*, 20 BERKELEY TECH. L.J. 1247, 1249 (2005).

<sup>241</sup> In recent years, the agencies may have begun to prioritize collusion in ways that go beyond allocating enforcement resources. The agencies have targeted collusion for increased penalties, greater international cooperation, and the increased use of leniency programs to provide an incentive for colluding firms to come clean. Scott D. Hammond, Deputy Assistant Att'y Gen., U.S. Dep't of Justice, *The Evolution of Criminal Antitrust Enforcement Over the Last Two Decades* (Feb. 25, 2010), available at <http://www.justice.gov/atr/public/speeches/255515.htm>; Steven Labaton, *The World Gets Tough on Fixing Prices*, N.Y. TIMES, June 3, 2001. At the same time, they have debated whether courts should relax the legal rule governing monopolization, which is almost always an exclusionary offense, in order to raise the practical burden on plaintiffs. See *supra* note 36. By contrast, European competition policy-makers tend to express greater concern with exclusionary conduct. See, e.g., Eleanor Fox & Daniel Crane, *GLOBAL ISSUES IN ANTITRUST AND COMPETITION LAW* 123 (2010) (contrasting the European Union (E.U.) test for predatory pricing with the "very conservative" approach of U.S. courts); *id.* at 130 (E.U. law is more likely to require that a dominant firm deal with its rival than U.S. law); *id.* at 143 (noting "a significant divide" between the U.S. and E.U. on using competition policy to address margin squeezes by regulated firms); *id.* at 197 (the E.U. is less permissive than U.S. law on vertical restraints).

are counted. The most plausible way this could happen is if mixed cases – cases in which firms both collude and exclude – are not infrequent and are routinely viewed solely as collusion cases.<sup>242</sup> Under such circumstances, the agencies may appear to be directing their enforcement efforts toward collusion markedly more than they are doing in fact.

These three explanations – greater deterrence of exclusion, more enforcement resources aimed at collusion, and treating mixed cases solely as collusion matters – are collectively more likely than the fourth possibility, which is implicitly accepted by those who favor the error cost argument for downplaying collusion: that it is more difficult to distinguish harmful from beneficial conduct in collusion settings than exclusion settings. Yet only the fourth explanation tends to suggest that enforcers and courts are more likely to make errors in resolving exclusion allegations than collusion allegations.

It is hard to see why the difficulties identifying harm to competition would be systematically greater in the exclusion setting than the collusion one if the challenged conduct has no plausible efficiency justification in each case – that is, if we are thinking only about naked collusion and plain exclusion. It is also hard to see why the difficulties identifying anticompetitive practices would be greater in an exclusion setting for the rest of the relevant universe – that is, if the challenged conduct does have a plausible efficiency justification in each case.

For example, to pick an exclusionary practice,<sup>243</sup> a manufacturer requiring a retailer not to distribute rival manufacturers' products may benefit primarily because the practice creates efficiencies (as by eliminating double marginalization or otherwise aligning incentives between manufacturer and retailer), or it may benefit the firm primarily because the practice confers market power by excluding rival manufacturers from access to low cost distribution. It may be difficult to distinguish between these explanations. But it may equally be difficult to tell whether a retailing joint venture between two manufacturers, to pick a collusive practice, primarily benefits them by lowering production costs (as by generating scale economies) or by conferring market power through a reduction in the direct competition between them. It may also be difficult to tell whether an agreement among rivals to exchange information (perhaps implemented through their trade association) benefits competition by helping the firms match production to costs and demand or harms competition by facilitating

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<sup>242</sup> *Supra* notes 42-47 & 139-44 and accompanying text.

<sup>243</sup> Although it is hard to be confident that any example would be representative, the examples provided in this paragraph are sufficiently generalizable to make clear the argument.

collusion, as by helping them detect cheating rapidly.<sup>244</sup>

The casual but erroneous supposition that it is harder to distinguish harms from efficiencies in the exclusion setting is likely the result of a category mistake: comparing the difficulty of proving harm from naked cartels, where there is *no* plausible efficiency, with the difficulty identifying anticompetitive exclusionary practices when the conduct *has* a plausible justification.<sup>245</sup> Naked cartels probably come first to mind as a collusive practice given the frequency with which the enforcement agencies announce such cases. But when thinking about exclusion, the top-of-mind exclusionary practice is more likely a vertical contract with a plausible efficiency justification, not an example of plain exclusion such as those found to be violations in *Lorain Journal* or *Microsoft*. Antitrust analysis is sometimes easy and sometimes difficult, but the difficulties in distinguish harmful from beneficial conduct do not differ systematically between collusion and exclusion settings. Accordingly, there is no reason to expect more frequent enforcement and adjudicative errors in resolving exclusion cases than in evaluating collusion cases.

## 2. Relative Cost of Errors

For the reasons set forth above, downplaying exclusion cannot be justified based on the view that false positives are *more common* in the exclusion setting. If a justification remains, it would instead have to be based on a supposition that any errors that do occur are *more costly* when exclusion is alleged than when collusion is alleged. Two primary arguments have been offered for this latter supposition – one based on empirical studies and the other rooted in an analysis of institutional competence – but neither is convincing.

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<sup>244</sup> For case examples that suggest the difficulty of distinguishing harms to competition and efficiencies when collusion is alleged, *see, e.g.*, *United States v. Topco Associates, Inc.* (405 U.S. 596 (1972) (striking territorial restrictions on the marketing of private label products distributed by a joint venture among supermarkets, some of which were effectively horizontal rivals); *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979) (reversing lower court decision finding a blanket licensing agreement among rival copyright owners illegal per se); *In re Gen. Motors Corp.*, 103 F.T.C.374 (1984) (approving joint production venture between rival automakers subject to conditions).

<sup>245</sup> Similarly, it would be inappropriate to make inferences about the relative harm arising from exclusion and collusion by comparing the competitive harm from the typical naked cartel to the competitive harm from the typical instance of exclusionary conduct, whether plain or justified by an efficiency. *See* Aaron Edlin, *Predatory Pricing*, RESEARCH HANDBOOK ON THE ECONOMICS OF ANTITRUST LAW (Einer Elhauge, ed. 2010) (“Presumably, it is true . . . that most price cuts are pro-competitive . . . . However, no antitrust proposals attack all price cuts, so that sample is irrelevant.”).



First, some commentators suggest that the many empirical studies that have identified efficiencies and other competitive benefits from vertical integration and vertical agreements show that anticompetitive consequences of such practices are unlikely, so antitrust rules should favor defendants in exclusionary conduct categories.<sup>246</sup> But these studies would be probative only if they show that errors are more costly when exclusion is alleged than when collusion is alleged, which they do not.<sup>247</sup> Many of the cited studies do not discriminate between exclusionary and collusive explanations for vertical agreements;<sup>248</sup> taken at face value, they would question the prevalence of both explanations so cannot provide a basis for downplaying exclusion relative to collusion.<sup>249</sup> Moreover, the business decisions evaluated in these studies are commonly made under the shadow of the antitrust laws. Because of the deterrent effect of antitrust enforcement, the observed practices would be expected disproportionately to benefit

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<sup>246</sup> James C. Cooper, Luke M. Froeb, Dan O'Brien & Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005); Jeffrey Church, *Vertical Mergers*, ABA ANTITRUST SECTION, ISSUES IN COMPETITION LAW AND POLICY 1455, 1495–97 (2008); Geoffrey A. Manne & Joshua D. Wright, *Innovation and Antitrust*, 6 J. COMP. L. & ECON. 153, 161 n.23 (2010).

<sup>247</sup> The studies also do not bear on the relative frequency of errors, so do not show that false positives would be more frequent in exclusion cases than collusion cases.

<sup>248</sup> Cf. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 892–94 (2007) (discussing both collusive and exclusionary explanations for resale price maintenance).

<sup>249</sup> The prevention of free-riding can potentially justify both vertical and horizontal agreements. *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (vertical non-price agreement); *Polk Bros., Inc. v. Forest City Enter., Inc.*, 776 F.2d 185 (7th Cir. 1985) (horizontal market division agreement between potential rivals). “Free-riding” refers to the externality that arises when investments by one firm increase demand or reduce costs for rivals, and the first firm is not compensated for providing this benefit. The elimination of free-riding is frequently invoked to justify restrictions imposed by manufacturers on distributors, where the manufacturer claims that absent the restrictions, the dealer would not provide an appropriate level of services to customers or promotional investments. See generally Lester G. Telser, *Why Should Manufacturers Want Fair Trade?* 3 J.L. & ECON. 86 (1960); Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265 (1988); Benjamin Klein & Andres V. Lerner, *The Expanded Economics of Free-Riding: How Exclusive Dealing Prevents Free-Riding and Creates Undivided Loyalty*, 74 ANTITRUST L.J. 473 (2007). For other examples of business justification defenses considered in antitrust cases, see HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* §5.2 (4th ed. 2011) (horizontal joint ventures); Joseph Kattan, *Efficiencies and Merger Analysis*, 62 ANTITRUST L.J. 53 (1994) (horizontal mergers); Mary Anne Mason & Janet L. McDavid, *Business Justification Defenses*, ABA SECTION OF ANTITRUST LAW, 2 ISSUES IN COMPETITION LAW AND POLICY 1019 (2008) (monopolization cases); Michael Salinger, *Business Justification Defenses in Tying Cases*, ABA SECTION OF ANTITRUST LAW, 3 ISSUES IN COMPETITION LAW AND POLICY 1911 (2008) (tying cases).

competition even if they have anticompetitive potential in other settings.<sup>250</sup> In consequence, empirical studies evaluating exclusionary conduct provide little evidence of value regarding either the potential for those practices to harm competition<sup>251</sup> or the likelihood that the particular instances selected for enforcement in fact harm competition.<sup>252</sup>

The other commonly-offered justification for the view that errors are more costly when exclusion is alleged than when collusion is alleged turns on a claim about the institutional competence of enforcers and courts. For institutional competence to matter, enforcers and courts must make systematically different (and worse) errors when evaluating exclusion cases than in analyzing collusion cases. Because the main concern of those arguing to downplay exclusion is that false positives will chill procompetitive conduct, the issue turns on the relative incidence and significance of judicial errors when the conduct under review has a plausible efficiency justification. In the exclusion context, this includes price-cutting and new product introductions – conduct that at least in the short run benefits consumers.<sup>253</sup> There is no reason to think that enforcers

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<sup>250</sup> Relatedly, the leading studies of vertical restraints may have examined competitive effects primarily in relatively competitive markets, where those practices would not be expected to harm competition, rather than in sectors in which firms exercise substantial market power, where antitrust enforcement tends to be concentrated. Vincent Verouden, *Vertical Agreements: Motivation and Impact*, in ABA SECTION OF ANTITRUST LAW, 2 ISSUES IN COMPETITION LAW AND POLICY 1813, 1837 (2008). (Although defendants commonly prevail in vertical restraint cases, those outcomes frequently result from lack of proof of market power so they provide little guide to the likelihood that such conduct, whether exclusionary or collusive, would be justified when defendants have market power.) Furthermore, the prevalence of a practice in markets thought to perform competitively at best establishes that the practice could be procompetitive. It does not indicate whether the conduct could harm competition when employed by firms with market power or whether anticompetitive uses have been deterred by the threat of antitrust enforcement. Cf. Randal D. Heeb, William E. Kovacic, Robert C. Marshall & Leslie M. Marx, *Cartels as Two-Stage Mechanisms: Implications for the Analysis of Dominant-Firm Conduct*, 19 CHI. J. INT'L L. 213, 229 (2009) (loyalty rebates, which in theory can under some circumstances benefit competition and under other circumstances harm competition, are sometimes used with cartels).

<sup>251</sup> Empirical economic studies about the competitive effects of specific business practices are generally more useful for evaluating conduct in industries similar to those studied than for generalizing across industries to formulate legal rules. Jonathan B. Baker & Timothy F. Bresnahan, *Economic Evidence in Antitrust: Defining Markets and Measuring Market Power*, in HANDBOOK OF ANTITRUST ECONOMICS 1, 24-29 (Paolo Buccirossi, ed., 2008).

<sup>252</sup> By contrast, the many examples of anticompetitive conduct observed during periods of lax antitrust enforcement suggest the benefits of antitrust. Jonathan B. Baker, *The Case for Antitrust Enforcement*, 17 J. ECON. PERSP. 27 (2003).

<sup>253</sup> Collusive conduct can also appear to benefit consumers in the short run. Examples may include various practices facilitating coordination, such as the parallel adoption of

and courts will systematically fail to notice when defendants have a plausible efficiency justification in exclusion cases, while recognizing that possibility in collusion cases.<sup>254</sup> If, under such circumstances, outcomes are systematically biased in favor of plaintiffs in exclusion cases but not in collusion cases, that outcome would have to result from some aspect of the decision-making process that differs across the two settings.

The most common institutional competence argument presumes that exclusion cases are disproportionately prompted by the trumped up complaints of inefficient rivals, losers in the marketplace, who seek to overturn the market's verdict in the courts directly as plaintiffs or indirectly by inducing enforcement agency suits. If so, and if, in addition, complaining rivals bringing bad cases tend to have more influence over the judicial process than the firms wrongly accused of anticompetitive exclusionary conduct, then false positives would be more likely to arise in exclusion cases than in collusion cases.<sup>255</sup> Under such circumstances,

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simplified and common product definitions, the parallel adoption of price lists, or the parallel adoption of guarantees to buyers that they will get the best price the seller gives any buyer. Cf. Jonathan B. Baker, *Identifying Horizontal Price Fixing in the Electronic Marketplace*, 65 ANTITRUST L.J. 41 (1996) (describing competitive problems that can arise when rivals respond more quickly than customers to price announcements).

<sup>254</sup> To similar effect, some claim that antitrust enforcement against exclusion is problematic because it is difficult for courts to make the detailed factual assessments required to determine whether firms can solve their exclusion problems or to compare the harms from exclusionary conduct against the pro-competitive benefits. See, e.g., Geoffrey A. Manne & Joshua D. Wright, *Innovation and Antitrust* 6 J. COMP. L. & ECON. 153, 157 (2010) (characterizing Easterbrook's analysis as premised in part on the view that "errors of both types are inevitable, because distinguishing procompetitive conduct from anticompetitive conduct is an inherently difficult task in the single firm context"). Yet if fact-finding is the problem with comprehensive reasonableness review of exclusion allegations, it raises a comparable difficulty for collusion enforcement under the comprehensive rule of reason, where a court must determine whether firms can solve their collusion problems and whether the benefits to competition dissipate or eliminate the harms. See *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 916-17 (2007) (Breyer, J., dissenting) (noting the difficulties of assessing whether the benefits of resale price maintenance in preventing free riding outweigh the potential harm of facilitating a dealer cartel, and the difficulties judges and juries may face in evaluating market power).

<sup>255</sup> See, e.g., WILLIAM J. BAUMOL, ROBERT E. LITAN & CARL J. SCHRAMM, *GOOD CAPITALISM, BAD CAPITALISM, AND THE ECONOMICS OF GROWTH AND PROSPERITY* 8-19 (2007); cf. Edward A. Snyder & Thomas E. Kauper, *Misuse of the Antitrust Laws: The Competitor Plaintiff*, 90 MICH. L. REV. 551 (1991) (a small minority of the 37 horizontal restraints cases filed by competitor plaintiffs between 1973 and 1983 in five federal districts alleging exclusionary practices seemed meritorious). If the courts do not weed out false claims from competitors, moreover, even efficient rivals would be expected to bring unwarranted exclusion claims in order to discourage hard competition from dominant firms.

antitrust institutions would inappropriately tend to protect competitors rather than competition in exclusion cases, but not so often in collusion cases, consistent with what those making this institutional competence argument contend.<sup>256</sup>

This argument about institutional competence is unconvincing, however, because there is no reason to think that the agencies and courts are biased in favor of the victims of alleged exclusion,<sup>257</sup> or that unsuccessful rivals can systematically convince the enforcement agencies and courts to accept bad cases.<sup>258</sup> Even if unsuccessful rivals or terminated dealers foresee the possibility of substantial gains from bringing a speculative (or even trumped up) antitrust complaint, they must also consider the low probability of success in determining the expected gain, and thus when deciding whether to bring a case. After all, it is no more difficult for enforcers and courts to understand the possible biases of rivals, and discount their testimony appropriately, than for those decision-makers to discount as necessary the testimony of alleged excluding firms and customers.<sup>259</sup> More than most firms, moreover, defendants in exclusion cases, particularly large firms accused of monopolization, tend to have the ability to present an effective courtroom case, employing top quality legal representation and economic experts and supporting them with a generous

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<sup>256</sup> Cf. *Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477, 488 (1977) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962) (antitrust aims to protect “competition, not competitors”).

<sup>257</sup> One commentator speculates without evidence that antitrust enforcers tend to sympathize with smaller firms. D. Daniel Sokol, *The Strategic Use of Public and Private Litigation in Antitrust as Business Strategy*, 85 SO. CAL. L. REV. (forthcoming 2012) (text at the end of section V.C). It is also possible that juries could systematically misinterpret colorful evidence of defendant intent to crush rivals as indicating an aim to do so through anticompetitive means (rather than by lowering costs and prices or introducing new or better products), notwithstanding jury instructions making the relevant distinction. The likelihood and magnitude of the possible prejudicial effect of such evidence on the interpretation of aggressively competitive conduct close to the line is hard to assess, but if it is important systematically, it is better addressed through rulings on the admissibility of evidence in those cases where the problem may arise rather than through caution in enforcing the antitrust laws against anticompetitive exclusion generally.

<sup>258</sup> In addition, the antitrust injury requirement, introduced at the start of antitrust’s Chicago school revolution, limits the possible misuse of the antitrust laws in this way. *Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477 (1977).

<sup>259</sup> Cf. Staff Analysis and Findings, Applications of AT&T Inc. and Deutsche Telekom AG For Consent To Assign or Transfer Control of Licenses and Authorizations, FCC WT Docket No. 11-65 at 44-45 n.255 (Nov. 29, 2011), available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DA-11-1955A2.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-11-1955A2.pdf) (describing interests of merging firms and merger opponents and their possible alignment with the public interest).

budget.<sup>260</sup> Large firm defendants in exclusion cases also tend to have the resources to make an effective public relations case and mobilize political support.<sup>261</sup>

### 3. Other Error Cost Arguments

Other error cost arguments for prioritizing collusion over exclusion are also unconvincing. Some suggest, consistent with Justice Scalia's *Trinko* dicta,<sup>262</sup> that false negatives are limited in antitrust cases because markets are almost invariably self-correcting,<sup>263</sup> or that false positives are particularly expensive to society because market power rather than competition forms the primary spur to innovation.<sup>264</sup> Those controversial claims should not be accepted.<sup>265</sup> Market power is often durable: economic theory suggests many reasons why monopoly power would not be transitory,<sup>266</sup> and the case law offers many examples of durable market

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<sup>260</sup> *But see* D. Daniel Sokol, *The Strategic Use of Public and Private Litigation in Antitrust as Business Strategy*, 85 So. Cal. L. Rev. (forthcoming 2012) (dominant firms do not employ effective counterstrategies because they are prone to inertia, focused on running their business, arrogant, and unsympathetic victims).

<sup>261</sup> Another institutional competence argument concerns remedy. Exclusionary violations are sometimes said to be difficult to remedy in rapidly-changing industries, where dramatic changes in the marketplace are likely to occur between the date of violation and the time a court determines liability and crafts relief. Even when remedies that would restore competition in the market under review appear limited, however, remedies providing general deterrence (such as fines and damages) remain available. *United States v. Microsoft Corp.*, 253 F.3d 34, 49 (D.C. Cir. 2001). *Cf.* Louis Kaplow, *An Economic Approach to Price Fixing*, 77 ANTITRUST L.J. 343, 416-32 (2011) (preferring fines to injunctions as the sanction for collusion on general deterrence grounds).

<sup>262</sup> *Supra* notes 12-19 and accompanying text.

<sup>263</sup> *E.g.*, Fred S. McChesney, *Easterbrook on Errors*, 6 J. COMP. L. & ECON. 11, 16 (2010); Fred S. McChesney, *Talkin' 'Bout My Antitrust Generation: Competition for and in the Field of Competition Law*, 52 EMORY L.J. 1401, 1412 (2003); Keith N. Hylton, *The Law and Economics of Monopolization Standards*, in ANTITRUST LAW AND ECONOMICS 82, 102 (Keith N. Hylton, ed. 2010); *see* Geoffrey A. Manne & Joshua D. Wright, *Innovation and Antitrust* 6 J. COMP. L. & ECON. 153, 157 (2010) (claiming that Easterbrook's analysis is premised in part on the view that "false positives are more costly than false negatives, because self-correction mechanisms mitigate the latter but not the former").

<sup>264</sup> *See* David S. Evans & Keith N. Hylton, *The Lawful Acquisition and Exercise of Monopoly Power and Its Implications for the Objectives of Antitrust*, COMPETITION POL'Y INT'L at 203 (2008).

<sup>265</sup> For a discussion of other arguments potentially related to the balance of error costs in the context of monopolization enforcement, *see* Jonathan B. Baker, *Preserving a Political Bargain: The Political Economy of the Non-Interventionist Challenge to Monopolization Enforcement*, 76 ANTITRUST L.J. 605, 616-20 (2010).

<sup>266</sup> *See, e.g., see* Ariel Ezrachi & David Gilo, *Are Excessive Prices Really Self-Correcting?* 5 J. COMPETITION L. & ECON. 249 (2008) (supracompetitive prices only attract

power,<sup>267</sup> including in high-tech markets.<sup>268</sup> Moreover, the empirical evidence indicates that the push of competition is generally more important for innovation than the pull of monopoly.<sup>269</sup> Hence a focus on “dynamic competition” does not justify exclusionary conduct such as monopolization.<sup>270</sup> For the present discussion, though, the more important point is that even if these suspect claims were accepted, they would not justify the rhetorical consensus prioritizing collusion: they would be reasons to oppose *all* antitrust enforcement, not to downgrade exclusion relative to collusion.

Another error cost argument has been accepted by some U.S. courts as a reason to allow a monopolist to make exclusive vertical agreements: the claim that exclusionary practices cannot make matters worse (and thus cannot harm competition) because there is a “single monopoly profit.”<sup>271</sup> This possibility does not justify treating exclusion less seriously than collusion, however, because the argument applies only in narrow circumstances.<sup>272</sup> If the excluding firms have literally no fringe rivals and face no potential entrants, and if there are no ways that buyers can substitute away from the monopoly, then there would indeed be no way to increase the rents from exercising market power through (further) exclusionary conduct. Outside of such unusual facts, though, firms can potentially

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entry efforts if they signal that the post-entry price would be high or that the incumbent firms have high costs, and even then entry may not succeed in competing those prices down to competitive levels); *cf.* Oliver E. Williamson, *Delimiting Antitrust*, 76 GEO. L. REV. 271, 289 (1987) (“Economies as an antitrust defense excepted, no one has provided a demonstration that the cost differences are as Easterbrook indicates. Easterbrook has an undischarged burden of proof that the cost of false positives in the market power region where strategic behavior is implicated is similarly low.”).

<sup>267</sup> *E.g.*, *United States v. Standard Oil Co.*, 221 U.S. 1 (1911); *United States v. Dentsply Int’l, Inc.*, 399 F.3d 181 (3d Cir. 2005).

<sup>268</sup> *E.g.* *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001).

<sup>269</sup> *See generally* Jonathan B. Baker, *Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation*, 74 ANTITRUST L.J. 575 (2007); Carl Shapiro, *Competition and Innovation: Did Arrow Hit the Bull’s Eye?*, in *The Rate and Direction of Inventive Activity Revisited* 361 (Josh Lerner & Scott Stern, eds. 2012).

<sup>270</sup> Jonathan B. Baker, “*Dynamic Competition*” *Does Not Excuse Monopolization*, 4 COMPETITION POL’Y INT’L 243 (2008); *cf.* *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 649 (1980) (rejecting the argument that the potential for supracompetitive prices to induce entry could justify horizontal price fixing).

<sup>271</sup> *E & L Consulting, Ltd. v. Doman Indus. Ltd.*, 472 F.3d 23 (2d Cir. 2006); *G.K.A. Beverage Corp. v. Honickman*, 55 F.3d 762, 767 (2d Cir. 1995); *Town of Concord v. Bos. Edison Co.*, 915 F.2d 17, 23, 32 (1<sup>st</sup> Cir. 1990) (Breyer, C.J.); *see* *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 36–37 (1984) (O’Connor, J., concurring).

<sup>272</sup> It is similarly possible that a horizontal agreement with no efficiency justification would not harm competition because the horizontal rivals are already coordinating perfectly. But this unlikely possibility does not justify downplaying the concern with collusive conduct.

obtain, extend or maintain their market power through exclusionary conduct that suppresses these forms of competition,<sup>273</sup> even if the excluded firms are less efficient competitors than the excluding firms.<sup>274</sup>

In sum, the policy (or error cost) arguments for downplaying exclusion do not stand up to analysis, whether grounded in common ideas about the difficulty distinguishing procompetitive conduct from anticompetitive exclusion or in the more controversial arguments made in *Trinko*. The close relationship between the ways by which exclusion and collusion allow firms to exercise market power, and the convergence in the legal rules governing exclusionary and collusive conduct, do not mislead. Exclusion should not be treated as a less serious offense than collusion.

## VI. IMPLICATIONS FOR ENFORCEMENT

Exclusion should be recognized as a core concern of competition policy along with collusion, and the common rhetorical convention that treats anticompetitive exclusionary conduct as of lesser importance than

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<sup>273</sup> See generally Andrew I. Gavil, William E. Kovacic & Jonathan B. Baker, ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY 417–18 (2d ed. 2008) (example in which a monopolist manufacturer harms competition by consolidating distribution in one dealer); *id.* at 861–65 (example in which single monopoly profit theory holds when downstream buyer uses monopolized product in fixed proportions with other inputs but fails to hold when the product is used in flexible proportions); *id.* at 811–12 (example in which a monopolist achieves additional market power through the exclusionary effect of tying). See also Timothy F. Bresnahan, *Monopolization and the Fading Dominant Firm*, in COMPETITION LAW AND ECONOMICS: ADVANCES IN COMPETITION POLICY ENFORCEMENT IN EUROPE AND NORTH AMERICA 264 (Abel Mateus & Teresa Moreira, eds. 2010) (demonstrating that a dominant firm threatened by rival innovation can profit by blocking those rivals, leading to the failure of the single monopoly profit theory in the case of technologically dynamic industries). An incumbent monopolist would also be unable to increase its market power through exclusion in an unusual case in which it has sufficient bargaining power to permit efficient entry while appropriating virtually all the rents. Cf. Phillippe Aghion & Patrick Bolton, *Contracts as a Barrier to Entry*, 77 AM. ECON. REV. 388 (1987) (model in which the manufacturer and distributor seek to allow efficient entry and extract all the rents the entrant creates, but bargaining over splitting the surplus can break down when the parties have imperfect information). The economics literature has also considered the applicability of the “single monopoly profit” argument in the context of “monopoly leveraging” concerns outside the scope of the present discussion. See generally Patrick Rey & Jean Tirole, *A Primer on Foreclosure*, in 3 HANDBOOK OF INDUSTRIAL ORGANIZATION 2145, 2182–83 (Mark Armstrong & Robert Porter, eds. 2007) (discussing models of “horizontal foreclosure”); cf. Steven C. Salop & R. Craig Romaine, *Preserving Monopoly: Economic Analysis, Legal Standards, and Microsoft*, 7 GEO. MASON L. REV. 617, 624–26 (1999) (distinguishing between application of the “single monopoly profit” argument to monopoly leveraging allegations and preserving monopoly allegations).

<sup>274</sup> See *supra* note 179.

anticompetitive collusion should be resisted. Doing so could lead enforcers to place a higher priority on challenging exclusion than they do today, particularly aiming to prevent exclusionary conduct that forecloses potential entry in markets subject to rapid technological change. It is particularly important to reaffirm the innovation benefits of antitrust enforcement against anticompetitive exclusion in high-tech markets in the wake of the *Trinko* opinion's nod toward monopoly power as a means of encouraging innovation,<sup>275</sup> which risks leading lower courts astray.

Recognizing exclusion as a core competition problem is unlikely to lead courts to modify the substantive antitrust rules they employ to test exclusionary conduct. Those rules are, in general, well-crafted to test the reasonableness of firm conduct, whether the analysis is truncated or comprehensive. Nor is rhetorical parity likely to affect the frequency with which the courts address exclusionary conduct. Because the rules would not change, it is unlikely that private plaintiffs, which account for the bulk of antitrust litigation, would bring more exclusion cases (other than follow-ons in the event government actions against exclusionary conduct increase).<sup>276</sup> Government enforcers should treat exclusionary conduct as comparable in priority with collusive conduct, but as a practical matter the relative frequency of government cases alleging anticompetitive exclusion would increase only to the extent the enforcement agencies shift resources away from investigating and challenging anticompetitive collusion.<sup>277</sup> Even if the agencies did so aggressively, budgetary and staffing limitations would most likely permit the agencies to bring only a handful of additional exclusion cases.<sup>278</sup>

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<sup>275</sup> *Verizon Commc'ns Inc. v. Trinko*, 540 U.S. 398, 406 (2004).

<sup>276</sup> Neither the relative frequency of the underlying anticompetitive conduct nor the tools available to enforcers and plaintiffs for identifying them would directly be affected if exclusion is no longer described as a lesser antitrust offense. The number of exclusion cases could even decline. To the extent firms today have been misled by the common rhetoric, and incorrectly believe that anticompetitive exclusionary conduct would not successfully be challenged, a rhetorical change of course could increase deterrence, reduce the prevalence of such conduct, and, in consequence, reduce the frequency with which it is challenged.

<sup>277</sup> The frequency of government enforcement in various categories is surveyed in William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 ANTITRUST L.J. 377 (2003).

<sup>278</sup> In recent years, the Justice Department has brought between two and five non-merger civil actions annually and challenged twelve to twenty mergers during each of the least five years (fiscal years 2007-11), ANTITRUST DIV., U.S. DEP'T OF JUSTICE, WORKLOAD STATISTICS FY 2002-2011, [www.justice.gov/atr/public/workload-statistics.html](http://www.justice.gov/atr/public/workload-statistics.html), so has limited ability to increase the number of exclusion cases through reallocation of civil resources. The Antitrust Division also filed between forty and ninety criminal cases annually during these years. Because criminal exclusionary conduct cases are likely to be rare even if exclusion is viewed as having equal priority as collusion, the



The major benefit of recognizing that exclusion is comparably important as collusion would instead come from protecting the legitimacy of the antitrust rules governing exclusionary conduct against pressure for modifications that would limit enforcement inappropriately. Enforcers and courts would not be misled by the contemporary consensus in antitrust discourse to shy away from attacking anticompetitive exclusion in order to focus their efforts on collusive conduct. A rhetorical shift may also heighten the salience of the open questions in the formulation of the rules governing truncated condemnation of anticompetitive exclusion,<sup>279</sup> and thereby encourage the further development of the law in that area.

A shift in how exclusion is viewed could also matter for remedies, as it may encourage the Justice Department to raise the penalties for anticompetitive exclusionary conduct in appropriate cases through criminal enforcement.<sup>280</sup> The Justice Department has the discretion to challenge anticompetitive exclusionary conduct as a civil violation or to prosecute it criminally, in the same way that the government has the discretion to attack collusion civilly or criminally.<sup>281</sup> Criminal enforcement has been employed to attack exclusion in the past, as with a monopolization case brought against a dominant newspaper and its senior officials alleging exclusionary conduct similar to the anticompetitive practices attacked in *Lorain Journal*.<sup>282</sup> Today, however, criminal antitrust enforcement is directed at

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Justice Department is unlikely to be able to increase its exclusionary conduct case count substantially without shifting resources from criminal to civil investigations. The Federal Trade Commission would similarly have only limited ability to increase the number of exclusion cases through reallocation of resources.

<sup>279</sup> See *supra* notes 108-28 and accompanying text.

<sup>280</sup> The penalties could also be raised by awarding the government the ability to collect civil fines for antitrust violations. Harry First, *The Case for Antitrust Civil Penalties*, 76 ANTITRUST L.J. 127 (2009) (recommending that Congress enlarge government antitrust remedies to include civil penalties, and that the enforcement agencies initially target the use of those remedies to monopolization cases in which the exclusionary conduct had no efficiency justification or in which the defendant engaged in a systemic effort to maintain monopoly).

<sup>281</sup> The Justice Department challenged the lysine cartel criminally, for example, but brought a civil case when challenging price-fixing among the major airlines. Compare *United States v. Andreas*, 216 F.3d 645 (7<sup>th</sup> Cir. 2000) (upholding criminal convictions of executives conspiring to fix lysine prices) with *United States v. Airline Tariff Publ'g Co.*, 1994-2 Trade Cas. (CCH) ¶ 70,687, (D.D.C. 1994) (final consent decree settling airline price-fixing allegations).

<sup>282</sup> *Kansas City Star v. U.S.*, 240 F.2d 643 (1957). See also William E. Kovacic, *The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix*, 2007 COLUM. BUS. L. REV. 17 & n.44 (identifying three criminal monopolization cases brought during the early 1960s); cf. *United States v. Hilton Hotels Corp.*, 467 U.S. 1000 (9<sup>th</sup> Cir. 1972) (upholding criminal conviction of firms that conspiring to boycott suppliers, though the group boycott was collusive rather than

cartel conduct,<sup>283</sup> consistent with the common description of exclusion as a lesser offense.

If exclusion is viewed as central to antitrust, criminal prosecution would no longer be reserved for collusive conduct. When applied to exclusionary conduct, it would almost surely be directed at the most egregious cases of plain exclusion, in much the way that the government now targets only the most egregious naked cartels for indictment.<sup>284</sup> It would be easy to imagine a criminal antitrust indictment (as well as other criminal charges) brought against senior executives if, for example, a dominant firm harms competition by destroying its key rival's factory,<sup>285</sup> or a price-fixing cartel engages in cooperative conduct to exclude an actual or potential rival that threatened to destabilize their collusive arrangement. Just as the Justice Department employs criminal cartel enforcement to attack clearly reprehensible collusive conduct – agreements among rivals concerning price or dividing markets with no efficiency justification – it would be expected to reserve criminal exclusion enforcement for clearly reprehensible

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exclusionary). Only a small fraction of antitrust cases prosecuted criminally have involved exclusionary practices. Joseph C. Gallo, Kenneth G. Dau-Schmidt, Joseph L. Craycraft & Charles J. Parker, *Criminal Penalties Under the Sherman Act: A Study of Law and Economics*, 16 RESEARCH IN L. & ECON. 25, 28 (1994) (finding that thirty-three, or 2%, of the 1522 criminal antitrust cases brought by the Justice Department between 1955 and 1993 involved exclusionary practices).

<sup>283</sup> “In general, current [Antitrust] Division policy is to proceed by criminal investigation and prosecution in cases involving horizontal, *per se* unlawful agreements such as price fixing, bid rigging, and customer and territorial allocations. . . . [C]ivil prosecution is used with respect to other suspected antitrust violations . . . .” U.S. Dept. of Justice, ANTITRUST DIVISION MANUAL III-20 (4th ed. Dec. 2008), available at <http://www.justice.gov/atr/public/divisionmanual/atrdivman.pdf>. Accord, Thomas O. Barnett, *Criminal Enforcement of Antitrust Laws: The U.S. Model* (Sept. 14, 2006), available at <http://www.justice.gov/atr/public/speeches/218336.htm> (“the Division focuses its criminal enforcement . . . narrowly on price fixing, bid-rigging, and market allocations, as opposed to the ‘rule of reason’ or monopolization analyses used in civil antitrust law”). In the past, however, the Antitrust Division has indicated that criminal enforcement is appropriate when predatory (exclusionary) conduct supports collusion. REPORT OF THE ATTORNEY GENERAL’S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 350 (1955) (statement of Assistant Attorney General Stanley N. Barnes).

<sup>284</sup> See generally Donald I. Baker, *To Indict or Not to Indict: Prosecutorial Discretion in Sherman Act Enforcement*, 63 CORNELL L. REV. 405 (1978); cf. William E. Kovacic, *The Modern Evolution of U.S. Competition Policy Enforcement Norms*, 71 ANTITRUST L.J. 377, 416–25 (2003) (describing the progressive evolution of the U.S. norm treating cartel behavior as criminal conduct since the 1970s, and providing statistics concerning the relative frequency of criminal (DOJ) and civil (FTC) enforcement against anticompetitive horizontal agreements).

<sup>285</sup> Cf. *United States v. Empire Gas Corp.*, 537 F.2d 296, 298 n.1 (8th Cir. 1976) (corporate president acquitted in criminal case alleging destruction of property; the Justice Department also brought an unsuccessful attempt to monopolize case against the firm).

exclusionary conduct – exclusion of all significant rivals through means lacking any efficiency justification.<sup>286</sup> In both settings, therefore, the Justice Department would limit criminal enforcement to only a subset of the cases to which truncated condemnation applies. If plain exclusion is less frequently observed than naked collusion,<sup>287</sup> criminal enforcement in exclusion cases would be rare – cartel cases would remain the mainstay of the Justice Department’s criminal enforcement efforts – but that is not a reason to avoid criminal sanctions in appropriate exclusionary conduct cases.

### CONCLUSION

Enforcers and commentators routinely describe anticompetitive exclusion as a lesser offense than anticompetitive collusion. The absence of rhetorical parity misleads because the two types of conduct harm competition in similar ways and are treated comparably in the framing of antitrust rules. Nor do policy considerations, whether or not framed in “error cost” terms, suggest downplaying exclusion relative to collusion in antitrust enforcement.

The rhetorical relegation of anticompetitive exclusion to antitrust’s periphery must end. The more that exclusion is described as a lesser offense, the more its legitimacy as a subject for antitrust enforcement will be undermined and the greater the likelihood that antitrust rules will eventually change to limit enforcement against anticompetitive foreclosure when they should not. It is time to recognize that exclusion, like collusion, is at the core of sound competition policy.

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<sup>286</sup> The moral condemnation and loss of liberty associated with criminal sanctions would thus be limited to the perpetrators of serious anticompetitive conduct that firms and their managers should have understood in advance would be subject to criminal prosecution.

<sup>287</sup> See *supra* notes 239-40 and associated text.