EXCLUSION AS A CORE COMPETITION CONCERN

Jonathan B. Baker

February 8, 2012

ABSTRACT

This article challenges the consensus in contemporary antitrust discourse placing exclusionary conduct at the periphery of competition policy. Contrary to common antitrust rhetoric, exclusion is as central as collusion as a matter of precedent, economics, the structure of doctrinal rules, and sound competition policy. The article’s economic analysis incorporates the modern learning about the conditions for profitability of foreclosure through purchase of an exclusionary right; its legal analysis synthesizes from the case law a truncated rule for the reasonableness review of exclusionary conduct across a wide range of doctrinal categories; and its policy analysis explains why decision-theoretic (error cost) considerations do not suggest a lesser role for exclusion than collusion. Recognizing exclusion as a core antitrust concern will protect the legitimacy of antitrust’s exclusionary conduct rules against pressure for modifications that would limit enforcement. It may also encourage criminal prosecutions of exclusionary conduct and shift enforcement attention toward preventing exclusionary conduct that forecloses potential entry in markets subject to rapid technological change.
EXCLUSION AS A CORE COMPETITION CONCERN

Jonathan B. Baker*

INTRODUCTION

Exclusionary conduct 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, or the “supreme evil” of antitrust is identified, the reference is invariably to cartels. At the same time, antitrust is “more cautious” in condemning exclusion than collusion.

The antitrust enforcement agencies today similarly emphasize collusion over exclusion in articulating enforcement priorities. It is

---

* 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 CLPINZ workshop participants, Aaron Edlin, Pat DeGraba, Harry First, Scott Hemphill, Heather Hughes, Prasad Krishnamurthy, James May, Steve Salop, David Snyder, Peter Taylor and Josh Wright, and participants in the faculty business law workshop at American University and the law and economics workshop at Berkeley Law School.

1 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.


“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). 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). Consistent with their rhetoric, the enforcement 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, while simultaneously debating whether courts should relax the legal rule governing monopolization in order to raise the practical burden on plaintiffs.


7 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), available at http://www.justice.gov/atr/public/speeches/206455.htm. In these remarks, the agency heads were highlighting their enforcement priorities, not describing past case frequencies. Since 1980, U.S. cases involving 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). 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.) 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).


9 During the George W. Bush administration, the Justice Department encouraged courts to adopt a legal rule governing monopolization 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).
In downplaying exclusion, antitrust rhetoric adopts the views of commentators associated with the Chicago school. Judge Robert Bork displayed deep skepticism about exclusion as an antitrust theory, particularly as applied to dominant firm conduct, in his influential book *The Antitrust Paradox*. In Bork’s view, courts should almost never credit the possibility that a firm could exclude rivals by refusing to deal with suppliers or distributors, or otherwise force rivals to bear higher distribution costs. Judge Richard Posner has similarly described anticompetitive exclusion as “rare.”

The current rhetorical consensus over the lesser priority for exclusion is surprising, for three reasons. First, any consensus itself is notable because 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. Over the course of antitrust history, the Supreme
Court has repeatedly altered its approach to evaluating the legality of vertical non-price restraints. The modern legal rule nearly inverts the rule applied forty-five years ago. The standard used to test vertical agreements concerning price has been even less consistent, and remains contested, although the case law did not explicitly associate resale price maintenance


17 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).

Exclusion as a Core Competition Concern

with exclusion until recently. A switch of one vote would have led the Supreme Court to abandon the longstanding per se prohibition against tying. Monopolization standards are also controversial, as is evident from a debate between the federal antitrust enforcement agencies early in the 21st century. In short, in the doctrinal categories most closely associated with exclusion, antitrust norms are “contested.”

Moreover, the most significant divide between Chicago school and post-Chicago antitrust commentators arises over their views on exclusionary conduct. Professor Steven Salop, a leading post-Chicago antitrust commentator, has emphasized the importance of antitrust’s concern with exclusionary conduct. Salop rejects the view “that virtually all exclusion claims are chimerical.” Instead, his work explains why “[t]he concepts of anticompetitive foreclosure and leverage are not empty and illogical,” and shows how exclusionary strategies can profit firms and harm competition.

The rhetorical consensus downplaying the significance of exclusionary conduct is also surprising because exclusion is well established as a serious competitive problem in both antitrust law and industrial organization economics. On the legal side, many key U.S. antitrust decisions, including recent ones, have been concerned primarily with exclusionary conduct. Microsoft made it difficult for Netscape to

---

21 See supra note 9.
Exclusion as a Core Competition Concern

Feb. 8, 2012

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. Standard Oil exploited its leverage over the railroads to stop the entry of new refiners in order to protect its monopoly in oil refining. 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. Visa and MasterCard prevented member banks from issuing American Express and Discover cards in order to protect their own market power. During the modern era, moreover, the Supreme Court and the appeals courts have addressed exclusionary conduct without consistently favoring either defendants or plaintiffs. As a matter of economics, as will be discussed in detail in

---

30 United States v. Visa, 344 F.3d 229 (2d Cir. 2003).
Section II below, collusion and exclusion are closely related – so much so as to make the reasons for concern about anticompetitive collusion equally reasons for concern about anticompetitive exclusion.

The rhetorical consensus giving exclusion lesser priority than collusion is also surprising for a third reason: preventing anticompetitive exclusion may be more important than deterring collusion for fostering economic growth. When antitrust cases address the suppression of new technologies, products, or business models, the disputes are almost always framed as exclusionary conduct allegations. Microsoft sought to prevent the development of a new method by which applications software could access computer operating systems, involving the combination of Netscape’s browser and Sun’s Java programming language, while the newspaper monopolist in *Lorain Journal* impeded the entry of a rival using a new technology, radio. In a recent example, 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 power in cable television.

Against this background, the common rhetorical convention treating exclusionary conduct as of lesser importance than collusion is not just unwarranted; it is pernicious. The more that exclusion is downplayed

---

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).


rhetorically, the more that 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. Accordingly, this article explains why anticompetitive exclusion, like anticompetitive collusion, must be understood as a core concern of competition policy.

The problem addressed by this article is encapsulated in the Supreme Court’s decision in Verizon Communications Inc. v. Trinko. The central claim in that 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. The Court held that Verizon’s unilateral refusal to assist its rivals did not state a claim under the Sherman Act.

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. If the regulatory scheme is sufficiently extensive and effective, Trinko holds, antitrust enforcement may be displaced. But the sweeping rhetoric of Justice Scalia’s opinion for the Court – all dicta – minimizes the competitive concern arising from a monopolist’s unilateral exclusionary acts. The opinion can be understood more broadly to claim that monopolies are temporary, hence self-correcting, and that monopolies foster economic growth, on the view that the prospect of monopoly induces risk-taking and innovation.

---

38 Verizon was obligated to provide new entrants with interconnection services under the Telecommunications Act of 1996.
39 The statute incorporated specific mechanisms for promoting competition by requiring incumbent monopolists to deal with entrants.
highlights the risk of false positives from Sherman Act §2 enforcement and, at least with respect to the violation alleged in the case, the difficulty of crafting relief to avoid ongoing judicial supervision. It rhetorically cabins—in an earlier pro-plaintiff monopolization decision, *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, by describing *Aspen* as “at or near the outer boundary of Section 2 liability” and by declaring that collusion is the “supreme evil” of antitrust. In short, the rhetoric of *Trinko* sets forth a skeptical perspective that downplays antitrust enforcement against exclusionary conduct, at least when undertaken by a monopolist, and so tends to undermine the legitimacy of such enforcement efforts.

The article makes the case that exclusion is as central to antitrust as collusion in several ways. Section I shows that courts recognize a wide range of firm conduct that can harm competition through exclusion. Section II explains that as a matter of economics, exclusionary conduct and collusive conduct are closely related means of exercising market power. This section also clarifies the economics of exclusion by describing the three “exclusion problems” firms must solve in order for an anticompetitive exclusionary strategy to succeed, and identifies key factors affecting the profitability of an important method of exclusion extensively analyzed in the recent economics literature, the purchase of an exclusionary right. Section III demonstrates that courts do not formally place an extra burden on plaintiffs when they seek to prove anticompetitive exclusion by showing the parallels between the doctrinal rules courts apply to evaluate claims of anticompetitive exclusion and claims of anticompetitive collusion. This section also identifies an emerging truncated approach to evaluate exclusionary conduct analogous to the truncated reasonableness review that courts apply in evaluating collusive conduct under Sherman Act §1. Section IV explains why “error cost” considerations—policy considerations related to the balance rules create between false convictions and false acquittals—do not justify downplaying exclusion relative to collusion.

Section V sketches some implications for antitrust enforcement of recognizing exclusion as a core competition problem.

I. FORMS OF ANTICOMPETITIVE EXCLUSIONARY CONDUCT

Exclusionary conduct harming competition can take a wide range of forms, as the courts have recognized. This section divides the anticompetitive possibilities into three broad categories. 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. When adopting the exclusionary methods in the first category, the excluding firms act on their own, whether through the unilateral action of a single excluding firm or the joint action of a group of excluding firms. When employing exclusionary methods in the second category, the excluding firms coordinate with firms that are not rivals through the purchase of an exclusionary right. In the third category, the excluding firms discourage competition by altering their rivals’ incentives, in particular by credibly threatening the rivals with harm should those 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, or obtain a monopoly

---

48 Exclusionary conduct is, of course, only sometimes anticompetitive. Rather, rivals can be excluded without harm to competition, and practices that exclude rivals can help firms lower costs, improve products, or otherwise achieve efficiencies, as well as helping them obtain or maintain market power.


50 The categories are not intended to be mutually exclusive, the assignment of strategies to categories is arbitrary at times, some strategies could reasonably have been categorized in multiple ways, and this informal survey does not purport to identify every possible foreclosure strategy.

51 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.

52 Conwood v. United States Tobacco, 290 F.3d 768 (2002) (dominant manufacturer of snuff excluded a fringe rival by destroying its rival’s in-store display racks). 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). 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.
position through fraudulent acquisition of a patent. To similar effect, a vertically-integrated dominant firm could redesign its upstream product in order to create an incompatibility for its downstream rival. 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, engaging in sham litigation, or manipulating a regulatory scheme.

Other methods by which firms can impose constraints that exclude rivals may be less obvious but equally harmful. A vertically-integrated dominant firm can refuse to sell a key input to rivals, or degrade the quality of the input it provides, as by refusing to sell the highest quality inputs. A vertical merger may threaten anticompetitive exclusion by conferring an incentive on 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). A dominant firm can exclude its rivals by refusing to deal with their suppliers, thereby discouraging the suppliers from dealing with competing firms. A dominant firm that sells complementary products can

---


54 E.g. C.R. Bard, Inc. v. M3 Sys., Inc., 157 F.3d 1340, 1383 (Fed. Cir. 1998).
57 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).
58 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).
59 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).
60 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) (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.
61 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).
take customers away from an unintegrated rival, thereby reducing its scale of operations and so raising its costs. It can also accomplish the same end by tying its complementary products together, or offering discounts to buyers purchasing a package of products. 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 or parallel exclusionary conduct.

**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. 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

---

62 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. See generally, 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).

63 Cascade Health Solutions v. PeaceHealth, 515 F.3d 883 (9th Cir. 2008).


66 Alcoa, the early 20th 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.
worth it if the higher input price forces rivals to exit, or if the strategy raises competitors’ costs, and thus the market price, by more than the dominant firm’s own costs rise. 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.

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. 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.

---

67 E.g., Weyerhauser 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).

68 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).

69 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).

70 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).
Although firms can exploit a wide range of specific methods to foreclose their rivals, the harm to competition that arises can be understood within a common economic framework set forth in the next Section. That framework emphasizes the connection between exclusion and collusion as means of obtaining, maintaining or exercising market power.

II. THE ECONOMICS OF ANTICOMPETITIVE EXCLUSION

Exclusion and collusion are closely related methods of exercising market power. To see why, 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.\(^71\) 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.\(^72\) 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.\(^73\) With higher costs of production or


\(^73\) If RC is a prospective entrant, Coke may consider a broader range of exclusionary
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. 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.

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.

As the soft drink example demonstrates and the “involuntary cartel” terminology highlights, exclusion and collusion are complementary methods of obtaining market power. It does not matter to buyers whether the cartel is voluntary or involuntary; the price that buyers pay rises either way.

Exclusion and collusion are also closely related in other ways. Colluding firms need to exclude in order for their collusive arrangement to succeed. They may find it necessary to deter a cheating member through 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 69. (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 conditional on entry.)

Cf. Aaron Edlin & Joseph Farrell, Freedom to Trade and the Competitive Process (NBER 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). This discussion 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 firms and the excluding firms can maintain their market power in the primary market by foreclosing entry by new competitors seeking to sell the complementary product.

See ANDREW I. GAVIL, WILLIAM E. KOVACIC & JONATHAN B. BAKER, ANTITRUST
exclusionary conduct, or to exclude fringe rivals or new entrants in order to prevent new competition from undermining their collusive arrangement. Moreover, excluding firms may need to collude in order to successfully exclude, or to profit collectively from exclusionary conduct.

A. Solving “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 assuring profitability of their exclusionary strategy. These three problems – method, sufficiency, and profitability – may be termed “exclusion problems,” in parallel with the three “cartel problems” colluding firms

80 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, Oligopoly
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. If the excluded firms can inexpensively adopt counterstrategies to avoid or evade the exclusionary conduct, the excluding firms will be unable to solve this exclusion problem. In the soft drink example, if Coke and 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, the exclusionary strategy would not be successful. Moreover, if the method of exclusion requires coordination between Coke and Pepsi, the inquiry into means of exclusion would also include asking whether the excluding firm could successfully do so.

Second, the exclusionary conduct must be sufficient to harm competition. This condition requires that the excluded firm matter competitively; its exclusion must relax a constraint on competition from the excluding firms. 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 the ability of the excluding firms to raise market prices. The excluding firms must thus prevent the involuntary cartel from being undermined through repositioning or output expansion by unexcluded rivals, by entry of new competitors, or by cheating among the excluding firms. In a prospective exclusion case, the

Maintenance (Jan. 8, 2012) (unpublished manuscript, on file with author) (discussing the ways excluding firms solve their “cartel problems”).

81 For collusion to succeed, the firms must reach consensus on terms of coordination, deter cheating on those terms, and prevent new competition. 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).

82 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.

83 This counterstrategy is unlikely to work in practice, however, unless beer distributors can produce bottled products from concentrate.

84 This issue does not arise if there is only a single excluding firm, as would be the case if Coke was a dominant firm.

85 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 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 the inefficient firm allows a lower cost firm to expand output, as may or may not occur, the resulting production cost savings would create a countervailing benefit to aggregate surplus.
ability of excluding firms to solve the sufficiency problem might be inferred from an analysis of market structure, or from past history of successful exclusion. In a retrospective exclusion case, where market definition may be more difficult, evidence of actual competitive effects may also be available.

Finally, the conduct must be profitable for each excluding firm, individually. Each excluding firm must reasonably expect the additional profits it will obtain or maintain through the successful operation of an involuntary cartel would exceed the costs of achieving that arrangement. 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 firms that deal with a rival).

The cost of exclusion, and thus the profitability of anticompetitive exclusionary conduct, depends upon the nature and scope of the method used to exclude. Exclusionary strategies need not be expensive. A

---

86 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 idea economic underlies the truncated legal rule governing exclusionary conduct discussed below in Section III.B.


88 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.

89 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 prove when the profits from exclusion arise coincident with the costs, as in many non-price exclusion settings.

90 The costs may also include any expense associated with solving “cartel problems” 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.

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.\textsuperscript{92} 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.\textsuperscript{93} Even if the excluding firms can plausibly solve their “exclusion problems,” it is possible that their exclusionary conduct could also have a legitimate business justification, and that the resulting procompetitive benefits would dissipate or eliminate the anticompetitive harm.\textsuperscript{94} If the legal rule requires an inquiry into reasonableness – that is, if a truncated review is not appropriate\textsuperscript{95} – that inquiry would take place after the harm to competition is established, and thus after a determination whether the excluding firms can solve their “exclusion problems.”

\textbf{B. Purchase of an Exclusionary Right}

The survey of the forms of anticompetitive exclusionary conduct in Section I above divided the methods into three broad categories: constraints imposed on rival conduct, purchase of an exclusionary right, and commitment to tough competition. The recent economics literature on exclusionary conduct has paid particular attention to the ways that the “exclusion problems” suggested by the “involuntary cartel” perspective can

\textsuperscript{92} See Lorain Journal Co. v. United States, 342 U.S. 143 (1951).

\textsuperscript{93} Issues that arise in assessing the profitability of the purchase of an exclusionary right are discussed in Section II.B.

\textsuperscript{94} 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, \textit{The Real Rule of Reason: Bridging the Disconnect}, 1999 BYU L. REV. 1265; Michael A. Carrier, \textit{The Rule of Reason: An Empirical Update for the 21st Century}, 16 GEO. MASON L. REV. 827 (2009). Accordingly, this article follows a suggestion of Prof. Andrew Gavil, in describing 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. \textit{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 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).”).

\textsuperscript{95} See infra Section III.B.
be solved when the conduct falls in the second of these categories, the purchase of an exclusionary right. That 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.

The economics literature is concerned primarily with identifying conditions under which the purchase of an exclusionary right would be profitable for the excluding firms, thus explaining how the excluding firms solve the third “exclusion problem” in this context. To focus on the vertical interaction, the discussion 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 merged with 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). These exclusionary tactics may raise RC’s marginal costs directly, or reduce marginal costs by limiting access to bottlers or shelf space, respectively. 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).

Other exclusionary strategies, not discussed in detail here, resemble the purchase of an exclusionary right because they 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. Both of these practices may also harm competition through means other than exclusion (including facilitating collusion, dampening competition, or facilitating anticompetitive price discrimination), and both may also or instead permit firms to achieve efficiencies. In addition, resale price maintenance agreements 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. John Asker & Heski Bar-Isaac, Exclusionary Minimum Resale Price Maintenance (NYU Working Paper, 2011) available at http://ssrn.com/abstract=1911714.

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, 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.
RC’s post-entry profitability by increasing the threat of post-entry competition.\textsuperscript{99} 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, 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.\textsuperscript{100} 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 the related ability of RC to outbid Coke in order to obtain bottling or attractive shelf space.\textsuperscript{101} 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 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 bottling.

\textsuperscript{99} 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.

\textsuperscript{100} 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. Hence sellers of complements would 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.

\textsuperscript{101} 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.
for Coke.102

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.103 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.104 But RC’s profits could be large if it would be a more efficient producer than the excluding firms,105 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.106 Accordingly, if one firm, whether Coke or RC, has a substantial advantage in financing payments to the bottlers while the other does not, that firm may be able to outbid the

---

102 The discussion of one factor will make the alternative assumption that Coke seeks to prevent entry by RC through contracting with supermarkets for exclusivity.

103 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).

104 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.

105 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.

106 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.\footnote{\textsuperscript{107}}

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.\footnote{\textsuperscript{108}} 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.\footnote{\textsuperscript{109}} 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.\footnote{\textsuperscript{110}}
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. 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. The critical role of bottler expectations in 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 than 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.

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. That assumption may not always hold, however. In some settings, however, 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.

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. 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.
Feb. 8, 2011  

Exclusion as a Core Competition Concern  

25

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.\textsuperscript{113}

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.\textsuperscript{114} 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.\textsuperscript{115} Suppose, for example, that RC adopts a strategy of entering with canned soft drinks, not bottled, or 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 a contract. 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.\textsuperscript{116}

The range of factors at play in the economic analysis of foreclosure through the purchase of an exclusionary right should not obscure the close relationship between exclusion and collusion. If excluding firms are able to solve their “exclusion problems,” even after accounting for the strategic issues at stake in determining profitability when the excluding firms must induce cooperation among sellers of complements with their anticompetitive strategy, they can harm competition through the creation of an involuntary cartel. For this reason, the modern economic literature on exclusionary conduct does not justify treating such practices as lesser offenses than collusion.

III. LEGAL RULES GOVERNING EXCLUSION

Exclusion and collusion are not just similar as a matter of economics; they are also governed by similarly-structured legal rules.\textsuperscript{117} As will be seen, both types of allegations are generally reviewed under the rule of reason, and in applying that approach, courts employ analogous methods of truncation. This parallelism shows that courts do not place a higher burden on plaintiffs seeking to demonstrate anticompetitive exclusionary conduct.

Allegations of anticompetitive exclusion are tested under the rule of

\textsuperscript{116} 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.

\textsuperscript{117} This similarity arises in part because antitrust’s traditional legal categories do not divide perfectly along exclusion vs. collusion lines. 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. \textit{Supra} note 14. Within a doctrinal category, the legal rule generally does not differ depending on whether the allegation is collusive or exclusionary. The rules governing group boycotts may be an exception. The Supreme Court’s collusive group boycott decision in F.T.C. v. Superior Court Trial Lawyers Ass’n, 493 U.S. 411 (1990) (\textit{SCTLA}) treats that conduct as tantamount to price-fixing among rivals. \textit{Id.} at 423. The SCTLA majority does not make reference to the Court’s then-recent exclusionary group boycott decision, Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co., 472 U.S. 284 (1985). \textit{Stationers} appears to demand a more extensive showing (perhaps including proof of market power) before applying a \textit{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 \textit{Stationers} does not clearly delineate the elements of the \textit{per se} rule it applies.
reason in many doctrinal categories. Exclusive dealing allegations are evaluated for their reasonableness, whether challenged under the Sherman Act or the Clayton Act.\textsuperscript{118} Vertical agreements, which could result in exclusion, are reviewed under the rule of reason regardless of whether the agreement involves price or non-price terms.\textsuperscript{119} Tying and exclusionary group boycotts are evaluated under the rule of reason if a per se rule does not apply.\textsuperscript{120} The exclusionary conduct element of the monopolization offense is reviewed in a burden-shifting framework similar to that now applied to evaluate the reasonableness of conduct under Sherman Act §1.\textsuperscript{121}

When the rule of reason is applied to evaluate alleged exclusionary conduct, moreover, courts assess harm to competition by analyzing whether the excluding firms have (in a retrospective case) or plausibly can (a prospective case) solve their exclusion problems: identifying a practical method of exclusion, excluding rivals sufficient to ensure that competition is harmed, and assuring profitability of the exclusionary strategy.\textsuperscript{122} The availability of potential alternative sources of distribution to an excluded manufacturer, and the duration and costs of terminating the exclusivity


\textsuperscript{121} 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). See 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 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.

\textsuperscript{122} 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).
agreements that limit the excluded firm’s access to customers, may bear on whether the plaintiff was substantially or insignificantly excluded, while 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.\textsuperscript{123} Under the rule of reason, competition is harmed if the anticompetitive effect is not dissipated or eliminated by the benefits to competition associated with the business justification for the conduct at issue,\textsuperscript{124} or if the benefits could be achieved through practical alternative means resulting in less harm to competition.\textsuperscript{125}

A. Truncated Rule of Reason Review of Collusive Conduct

In applying the rule of reason to evaluate collusive conduct under Sherman Act §1, the courts have developed \textit{per se} rules and quick look approaches to truncate or structure the analysis.\textsuperscript{126} In brief summary, a horizontal restraint can be condemned without a comprehensive analysis of its effects on competition if three elements are demonstrated: (a) an agreement among rivals,\textsuperscript{127} (b) certain facts suggesting the likelihood of

\textsuperscript{123} E.g. Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157 (9th Cir. 1997); cf. NicSand, Inc. v. 3M Co, 507 F.3d 442 (6th 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).

\textsuperscript{124} The use of the “dissipated or eliminated” terminology rather than describing the court as “balancing” to determine whether the harms “outweigh” the benefits is discussed supra note 94.

\textsuperscript{125} See, e.g., 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 \textit{Law} framework). For a collection of cases, see ABA SECTION OF ANTITRUST LAW, \textit{ANTITRUST LAW DEVELOPMENTS} 57-58 (6th ed. 2007).

\textsuperscript{126} The terms “truncated” or “structured” refer to a collection of analytical approaches—\textit{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.

\textsuperscript{127} 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 from circumstantial evidence, that element may be difficult to assess. \textit{See generally}, Louis Kaplow, \textit{An Economic Approach to Price Fixing}, 77 \textit{ANTITRUST L.J.} 343 (2011); Louis Kaplow, \textit{Direct vs. Communications-Based Prohibitions on Price-Fixing}, J.
harm to competition; and (c) the absence of a plausible efficiency justification for the agreement at issue. In a truncated or quick look review, the second element may be satisfied by showing that the conduct falls in a traditional per se category (price-fixing or market division),\footnote{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).} by showing that anticompetitive effect is intuitively obvious based on facial analysis of the agreement,\footnote{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).} or (with retrospective conduct) through actual effects evidence demonstrating that competition has been harmed.\footnote{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 Trading Co., 381 F. 3d 717, 737 (7th 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).}

This approach is implemented through a burden-shifting framework developed by the lower courts.\footnote{See generally, 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). 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).} Plaintiff must satisfy an initial burden of production by demonstrating likely harm to competition.\footnote{Plaintiff may meet this burden with any of the limited factual showings 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.} 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 from the agreement is not dissipated or eliminated by the benefit to competition or that defendant had a practical less restrictive alternative. This burden-shifting framework implies that rule of reason review can be truncated in two senses: (i) 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) through categorization of the agreement, facial analysis of the agreement, or actual effects evidence, or (ii) 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.

Truncated condemnation of collusive horizontal agreements permits courts to limit the factual inquiry in order to reduce the costs of operating the legal system, and to provide 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. In practical effect, truncated condemnation of horizontal restraints makes it unnecessary for the fact-finder to undertake a detailed analysis of whether the rivals that reached an agreement solved their “cartel problems,” most importantly by avoiding the need to define markets, analyze market shares, and evaluate entry conditions. Thus, truncated condemnation in a prospective collusion case means that adverse competitive effects are inferred from the nature of the agreement and the absence of efficiencies, while truncated condemnation in a retrospective collusion case means that are inferred from actual effects evidence and the absence of efficiencies.

133 In general, the errors from truncation could go in either direction: truncated rules could sweep in conduct that should not be condemned, or insulate conduct that should be prohibited. The truncated approach applied to the review of horizontal agreements under Sherman Act §1 mainly risks false positives, however, because conduct that does not satisfy a quick look rule can still be reviewed under the comprehensive rule of reason. 134 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 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”); id. at 103-106 (discussing benefits and costs of per se condemnation). 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, this possibility would presumably be considered only after both plaintiff and defendant have satisfied their initial burdens of production.
B. Truncated Reasonableness Review of Exclusionary Conduct

When exclusionary conduct is reviewed under the rule of reason, courts may also limit the factual inquiry, but in a different way. Truncation in this setting would mean avoiding a detailed analysis of whether the excluding firms solved their “exclusion problems”: method, sufficiency, and profitability. In exclusion cases, as will be described, courts routinely truncate their review to limit the analysis of sufficiency and profitability.

To understand the import of truncation in the antitrust review of alleged anticompetitive exclusion, return to the soft drink example and 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. A comprehensive reasonableness analysis of those agreements would ask a wide range of questions, such as the following: Did these contracts in fact exclude RC? 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? 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? 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, would infer harm to competition from proof of only three elements: that Coke excluded RC, a significant rival; that Coke could exclude all other significant rivals (if any) through similar means; and that

---

135 For the purpose of explicating reasonableness analysis, it is immaterial whether the 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).

136 Bd. of Trade of City of Chicago v. United States, 246 U.S. 231 (1918).

137 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).

138 For example, were all significant rivals excluded?
the agreement 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 in effect inferred. This approach also simplifies the showing RC must make to prove that Coke solved another problem, sufficiency. In a prospective exclusion case, the plaintiff does not have to identify every rival and assess its particular circumstances – whether it was excluded in fact, and if not, its ability and incentive to undermine the possible exercise of market power through price cutting and output expansion. In a retrospective case, the plaintiff need not demonstrate that the excluding firms in fact exercised market power.

The courts have arguably adopted a common approach to condemn exclusionary conduct through a truncated analysis along the lines suggested by the previous example. In particular, synthesizing the leading cases, exclusionary conduct may be found unreasonable without a comprehensive analysis of the nature, history, purpose, and actual or probable effect of the practice if the excluding firms foreclose competition from all significant rivals – as when a dominant firm excludes its only significant competitor or all its significant competitors – and the exclusionary conduct lacks a plausible efficiency justification. Truncated condemnation on this basis

---

139 In a prospective exclusion case, Coke pre-existing market power may be relevant to showing how Coke would exclude its rivals (coercion? using monopoly profits to fund the purchase of exclusionary rights?) or to demonstrating the sufficiency of the exclusionary method Coke would employ, but as a matter of economics, proof of pre-existing market power would not be needed to conclude that Coke’s exclusionary conduct would harm to competition if the elements set forth in the text can be shown.


141 See 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). Under some circumstances, it may not be 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.

142 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
appears possible across most of the disparate legal categories in which exclusionary conduct allegations may be evaluated, including attempt to monopolize, exclusionary group boycott, non-price vertical restraints, and exclusive dealing.

The courts have not identified a general rule of this form, so have not explicited it as doctrine. In consequence, many questions about

\[143\text{ Lorain Journal Co. v. United States, 342 U.S. 143 (1951).} \]
\[145\text{ See Nw. Wholesale Stationers, Inc. v. Pac. Stationery and Printing Co., 472 U.S. 284 (1985) (remanding for review under legal rule creating the possibility of truncated condemnation). The Stationers Court used the term “per se rule,” but, in contrast to the traditional per se rules employed in the analysis of horizontal restraints, conditioned application of its rule on up to three elements including defendant market power. For this reason, its approach is better thought of as describing a truncated or structured inquiry. Accord, Toys “R” Us, Inc. v. F.T.C., 221 F.3d 928, 936 (7th Cir. 2000).} \]
\[146\text{ See Graphic Products Distrib., Inc. v. ITEK Corp., 717 F.2d 1560 (11th Cir. 1983) (affirming jury verdict for plaintiff upon proof of defendant market power absent evidence that the restraints were reasonably necessary to achieve a legitimate business purpose); cf. Eiberger v. Sony Corp., 622 F.2d 1068 (2d Cir. 1980) (unjustified exclusion condemned without inquiry into defendant market power); Andrew I. Gavil, Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance, 72 ANTITRUST L.J. 3, 8 n.29 (2004) (Cont’l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977), “strongly implies that if a plaintiff can demonstrate that its supplier possesses market power, the burden of production should shift to the defendant to justify its conduct”). Although non-price vertical restraints can be subject to truncated condemnation, rule of reason litigation of such agreements almost always ends with defendant prevailing. HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE §11.6b (4th ed. 2011); Andrew I. Gavil, William E. Kovacic & Jonathan B. Baker, Sidebar 4-1: Dealer Relations After Sylvania, in ANTITRUST LAW IN PERSPECTIVE: CASES, CONCEPTS AND PROBLEMS IN COMPETITION POLICY 369 (2d ed. 2008).} \]
\[147\text{ Cf. United States v. Dentsply Int’l., Inc., 399 F.3d 181 (3d Cir. 2005) (exclusive dealing conduct analyzed as monopolization).} \]
\[148\text{ I previously described a truncated legal rule established by the Supreme Court in two monopolization decisions: Aspen Skiing v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985) and Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451 (1992). Jonathan B. Baker, Promoting Innovation Competition Though the Aspen/Kodak Rule, 7 GEO. MASON L. REV. 495, 496 (1999). Under that rule, Sherman Act §2 is violated when a monopolist excludes rivals by restricting a complementary or collaborative relationship without an adequate business justification. This discussion updates my views to reflect more recent precedent. Most importantly, a number of questions about the elements of the rule which seemed open in 1999, id. at 503-505, have been addressed through the analytical framework set forth in United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir.} \]
truncated condemnation of exclusionary conduct remain open for future refinement, including the following five. First, can proof of excluding firm market power – that is, a showing that the excluding firm or firms collectively have a substantial market share – permit the inference that all significant rivals, actual or potential, are excluded from proof 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? If so, truncated condemnation could be undertaken without identifying all significant rivals and proving that all have been excluded.\(^{149}\) Exclusionary conduct could then 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. The Federal Trade Commission answered the question in the affirmative in a decision condemning an exclusionary group boycott.\(^{150}\)

Second, 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 (that is, regardless of the excluding firm’s market share)?\(^{151}\)

\(^{149}\) This possibility would 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 does 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 479-80 (6th ed. 2007).

\(^{150}\) Toys “R” Us, Inc., 126 F.T.C. 415, 590-608 (1998), aff’d, 221 F.3d 928 (7th 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 expanding output – would likely be greater the lower the market share threshold.

\(^{151}\) Suppose, for example, that a firm with a small share 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 seem sufficient to prove harm to competition if there is no practical way to compete without complying with the standard. To apply this truncated approach in a case brought under Sherman Act §2, the court would presumably conclude
The obvious logic of the inference created by the synthesized rule set forth above – a firm clearly can exercise market power by excluding all its rivals – implies that proof of pre-existing market power is unnecessary. But the case law has not addressed this question, as the truncated condemnation approach has most commonly been employed in monopolization cases, in which market power is a predicate for liability. Given the historical importance of defendant market share in evaluating allegations of anticompetitive exclusion outside of Sherman Act §2, it is possible that a court could ignore the above logic and require proof of excluding firm market power before truncating its reasonableness review in the latter settings too.

Third, is truncated condemnation available in a retrospective exclusion case without proof of market power but with a showing of actual anticompetitive effects? This truncation approach would follow the logic of a quick look approach established in collusive agreement cases, and it was endorsed by the Federal Trade Commission, but it has been questioned by the Seventh Circuit. Fourth, can truncated condemnation

that the monopoly power (or dangerous probability of success in obtaining such power) element of the offense is satisfied by evidence that the firm excluded all its rivals. See ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 229 (6th ed. 2007) (discussing proof of monopoly power through direct evidence).

153 See, e.g., ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 217 (6th ed. 2007) (“Since the early 1970s, judicial decisions [in exclusive dealing cases] have established a virtual safe harbor for market foreclosure of 20 percent or less”).
154 See 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). Such a holding could perhaps be justified on policy grounds as reducing the possibility of false positives in settings in which it is difficult to be sure that all rivals would be excluded. If market power must be demonstrated, that element is not invariably difficult to evaluate. Indeed, market definition, the market share calculation, and the resulting inference of market power do not seem to have been controversial 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 (2002) (moist snuff in the U.S.).
156 Toys “R” Us, Inc., 126 F.T.C. 415, 608 (1998), aff’d, 221 F.3d 928 (7th Cir. 2000).
157 In Republic Tobacco Co. v. N. Atlantic Trading Co., 381 F. 3d 717, 737 (7th Cir. 2004), the Seventh Circuit declined to allow plaintiff to dispense with market definition by proffering actual effects evidence in a vertical exclusion case. By contrast, an earlier decision in the same circuit held otherwise in an exclusionary group boycott setting. Wilk v. Am. Med. Ass’n, 895 F.2d 352 (7th Cir. 1990) (alternative holding).
be undertaken in predatory pricing cases that appear to satisfy the elements set forth above, or is that approach precluded by Supreme Court decisions establishing below-cost pricing and recoupment as elements of the predatory pricing offense?^{158} Fifth, what business justifications for exclusionary conduct are cognizable? In particular, 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? 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,^{159} but the rhetoric (though not the holding) in Trinko might appear to call that conclusion into question.^{160}

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. The most important open questions concern the factual showings that would be sufficient to satisfy the second element: the foreclosure of all significant rivals is enough, unless courts also choose to insist on proof of defendant market when the competitive harm is prospective, and it remains to be seen whether either defendant market power or evidence of actual adverse effects would also be sufficient.

---


^{160} Verizon Commc’ns Inc. v. Trinko, 540 U.S. 398, 406 (2004). Relatedly, 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”).
C. Naked Collusion and Plain Exclusion

Agreements among rivals that satisfy the conditions for truncated condemnation are often referred to as “naked collusion.” In this context, the term “naked” refers to the absence of an efficiency justification.161 By analogy, exclusionary conduct that satisfies the conditions for truncated condemnation can be described as “plain exclusion.”162 So-called “cheap exclusion” is a type of plain exclusion, namely plain exclusion that is also inexpensive to implement.163

Parallel truncated rules define naked collusion and plain exclusion. Each rule has a conduct predicate: agreement among rivals for one, and exclusionary acts for the other. Each relies on limited evidence to infer likely harm to competition, though the required factual showings vary between the rules. Each also requires the absence of a plausible efficiency justification. Moreover, comprehensive reasonableness analysis is available to evaluate the challenged conduct, regardless of whether the allegations are collusive or exclusionary, if the elements of the truncated rule do not apply. This parallelism in the structure of the legal rules demonstrates that courts do not formally place an extra burden on plaintiffs when they seek to prove anticompetitive exclusion, compared with what is required to prove anticompetitive collusion.

IV. ERROR COSTS AND LEGAL RULES

Some antitrust commentators claim that exclusion should be treated as a lesser offense than collusion on the ground that false positives (convictions) are more likely or more costly for exclusionary violations than for collusive ones, while false negatives (acquittals) are less likely and less costly for exclusion than collusion.164 These arguments rely upon an “error

164 E.g. Keith N. Hylton, The Law and Economics of Monopolization Standards, in ANTITRUST LAW AND ECONOMICS 82, 102 (Keith N. Hylton, ed. 2010).
cost” or decision-theoretic framework for evaluating antitrust rules, consistent with the approach to evaluating such rules adopted in recent decisions by the Supreme Court. As will be demonstrated in this section, however, “error cost” considerations provide no basis for rules that would treat exclusionary conduct as less serious than collusion. Rather, error cost analysis confirms that exclusion and collusion should be treated on an equal footing.

Any analysis of false positives and false negatives depends upon the specifics of the rules. The relevant rules today are those described above in

---

165 A decision-theoretic framework can be applied to compare alternative legal rules regardless of the way social welfare is defined. One common definition approach in antitrust commentary, often referred to as minimizing “error costs,” selects rules to minimize total social costs, which include the costs of false positives and false negatives, along with the transactions costs associated with the use of the legal process. The relevant “error costs” include costs of over- and under-deterrence; in evaluating antitrust rules, deterrence considerations are particularly important. See generally, Jonathan B. Baker, The Case for Antitrust Enforcement, 17 J. ECON. PERSP. 27 (2003). That is, the costs relevant to comparing rules 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. 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).


166 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 legality 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).
Section III: the parallel frameworks for evaluating exclusionary and collusive conduct under the rule of reason. The error costs associated with these rules undoubtedly differ from the error costs associated with the structural era antitrust rules that were criticized decades ago by Chicago school commentators.\textsuperscript{167} Hence, the error consequences of the antitrust doctrines that prevailed before the rules were reformed during antitrust’s Chicago school revolution are not useful for understanding the balance of error costs today.\textsuperscript{168}

Many error cost arguments deployed to criticize antitrust enforcement against alleged anticompetitive exclusionary conduct, if credited, would not justify downplaying exclusion relative to collusion because they would equally apply to criticize enforcement against alleged anticompetitive collusive behavior. Some suggest, for example, that false negatives are limited in antitrust cases because markets are almost invariably self-correcting,\textsuperscript{169} or that false positives are particularly expensive to society because market power rather than competition forms

\textsuperscript{167} Cf. 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) (briefly surveying 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).

\textsuperscript{168} 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”). To the extent there is a concern that permitting plaintiffs to bring antitrust claims arising from low prices would chill competition on price and thus create false positives, for example, that concern is addressed by the contemporary requirement of predatory pricing law that the predator’s prices must fall below the excluding firm’s costs. The below-cost pricing requirement also risks false negatives. See United States v. AMR Corp., 335 F.3d 1109 (10th Cir. 2003) (rejecting four methods of measuring cost proposed by the Department of Justice). Cf. Aaron Edlin, Predatory Pricing, in RESEARCH HANDBOOK ON THE ECONOMICS OF ANTITRUST LAW (Einer Elhauge, ed. 2010) (surveying legal policy issues 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).

\textsuperscript{169} 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”).
the primary spur to innovation. Those controversial claims should not be accepted, but if they are, they would be reasons to oppose all antitrust enforcement, not to downgrade exclusion relative to collusion.

Similarly, 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. 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. Moreover, it may or may not be more difficult to compare harms and benefits when market power and efficiencies occur within the same market than when they arise in different markets, but even

---


171 On the durability of market power, see Ariel Ezrachi & David Gilo, Are Excessive Prices Really Self-Correcting? 5 J. COMPETITION L. & ECON. 249 (2008); 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.”). On the greater significance of competition as a spur to innovation, see Jonathan B. Baker, Beyond Schumpeter vs. Arrow: How Antitrust Fosters Innovation, 74 ANTITRUST L.J. 575 (2007). 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).

172 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”).

173 See Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877, 916-17 (2007) (Breyer, J., dissenting) (difficulties of assessing whether the benefits of resale price maintenance in preventing free riding are likely to outweigh the potential harm in facilitating a dealer cartel, and difficulties judges and juries may face in evaluating market power).

174 Nor are the differences between the elements of naked collusion and plain exclusion likely to lead to systematic differences in applying a truncated reasonableness analysis in the two contexts, as both rules have elements that can be difficult to assess in some circumstances and easy in others. Moreover, a court is unlikely to condemn a practice using a truncated rule in preference to a comprehensive analysis of effects if it has difficulty determining whether one of the elements of the truncated rule is satisfied.
if comparisons within markets are easier, that possibility again would not systematically distinguish exclusion from collusion.\footnote{175 For example, the efficiency benefits of joint ventures or information exchanges among rivals – two types of potentially collusive practices – often would arise in the same markets in which harm to competition is threatened, as may the efficiency benefits of potentially exclusionary practices such as vertical agreements.}

Other error cost arguments, if credited, could in principle distinguish exclusion from collusion, but none successfully justifies downplaying exclusion. One is the claim, accepted by some U.S. courts as a reason to allow a monopolist to make exclusive vertical agreements, that exclusionary practices cannot make matters worse (and thus cannot harm competition) because there is a “single monopoly profit.”\footnote{176 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 (1st 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).} This possibility does not justify treating exclusion less seriously than collusion, however, because the argument applies only in narrow circumstances.\footnote{177 It is similarly possible that a horizontal agreement with no efficiency justification would not harm competition because the horizontal rivals are already colluding perfectly. But this unlikely possibility does not justify downplaying the concern with collusive conduct.} If the excluding firms have literally no fringe rivals and face no potential entrants, 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 obtain, extend or maintain their market power through exclusionary conduct that suppresses these forms of competition.\footnote{178 \textit{See generally}, Andrew I. Gavil, William E. Kovacic & Jonathan B. Baker, \textit{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); \textit{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); \textit{id.} at 811–12 (example in which a monopolist achieves additional market power through the exclusionary effect of tying). 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 all the rents. \textit{Cf.} Phillipe Aghion & Patrick Bolton, \textit{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. \textit{See generally}, Patrick Rey & Jean Tirole, \textit{A Primer on Foreclosure}, in 3 \textit{Handbook of Industrial Organization} 2145, 2182–83 (Mark Armstrong & Robert Porter, eds. 2007).}
even if the excluded firms are less efficient competitors than the excluding firms.\textsuperscript{179}

Some commentators also suggest that the many empirical studies that have identified efficiencies and other competitive benefits from vertical integration and vertical agreements justify tilting the antitrust rules toward defendants in exclusionary conduct categories.\textsuperscript{180} These studies have little relevance for balancing error costs in developing antitrust rules governing exclusion or collusion, however. Many of the cited studies do not discriminate between exclusionary and collusive explanations for vertical agreements,\textsuperscript{181} taken at face value, they would question the prevalence of both explanations so cannot provide a basis for downplaying exclusion relative to collusion.\textsuperscript{182} In addition, the business decisions evaluated in these

\textsuperscript{179} See supra note 85.


\textsuperscript{182} 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, \textit{Why Should Manufacturers Want Fair Trade?} 3 J.L. & ECON. 86 (1960); Benjamin Klein & Kevin M. Murphy, \textit{Vertical Restraints as Contract Enforcement Mechanisms}, 31 J.L. & ECON. 265 (1988); Benjamin Klein & Andres V. Lerner, \textit{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, \textit{FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE} §5.2 (4th ed. 2011) (horizontal joint ventures); Joseph Kattan, \textit{Efficiencies and Merger Analysis}, 62 ANTITRUST L.J. 53 (1994) (horizontal mergers); Mary Anne Mason & Janet L. McDaid, \textit{Business Justification Defenses}, ABA SECTION OF ANTITRUST LAW, 2 ISSUES IN COMPETITION LAW AND POLICY 1019 (2008) (monopolization cases); Michael Salinger, \textit{Business Justification Defenses in Tying Cases}, ABA SECTION OF ANTITRUST LAW, 3
studies are commonly made under the shadow of the antitrust laws. To the extent that antitrust enforcement deters conduct that would harm competition, the practices studied would be expected disproportionately to benefit competition even if they have anticompetitive potential in other settings.\footnote{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, \emph{Vertical Agreements: Motivation and Impact}, in ABA Section of Antitrust Law, 2 \emph{Issues in Competition Law and Policy} 1813, 1837 (2008). 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.} In consequence, studies evaluating such conduct provide little evidence regarding the potential for those practices to harm competition, even when the anticompetitive theory contrasted with an efficiency explanation is clearly exclusionary, and not ambiguous.\footnote{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, \emph{Economic Evidence in Antitrust: Defining Markets and Measuring Market Power}, in \emph{Handbook of Antitrust Economics} 1, 24-29 (Paolo Buccirossi, ed., 2008).} By contrast, the many examples of anticompetitive conduct observed during periods of lax antitrust enforcement suggest the benefits of antitrust.\footnote{Jonathan B. Baker, \emph{The Case for Antitrust Enforcement}, 17 J. Econ. Persp. 27 (2003).}  

A related error cost argument for downplaying exclusion inappropriately infers that collusion is the greater concern from observing that the antitrust enforcement agencies and courts almost surely find more examples of naked collusion than plain exclusion.\footnote{Cf. Jonathan M. Jacobson, \emph{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”). It would also be inappropriate to make inferences about the relative harm to competition from collusion and exclusion by comparing the frequency or other features of plain collusion cases with the corresponding features of all exclusion cases (going beyond plain exclusion). See Aaron Edlin, \emph{Predatory Pricing}, \emph{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.”).} That difference likely has many explanations having nothing to do with the distribution of error costs, including the priority the agencies give to collusion investigations.\footnote{See supra at text accompanying notes 6-9. Moreover, if exclusionary conduct
differences in difficulties of proof, and the possibility that the antitrust laws more successfully deter plain exclusion than naked collusion. The last possibility, if credited, could suggest devoting more enforcement resources to investigating collusion than exclusion, but does not imply that antitrust rules should downplay exclusion or that the enforcement agencies should treat exclusion as a second class offense.

A final argument suggesting that exclusion should be downplayed relative to collusion is based on the claim that enforcers and courts make systematically different (and worse) errors when evaluating exclusion cases relative to collusion cases. This institutional argument is predicated on two debatable assumptions. First, it 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 (second assumption) if 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 could be more likely to arise in exclusion cases than in collusion cases. Under such circumstances, antitrust institutions would lacking any plausible business justification is commonly attacked under non-antitrust statutes, such conduct may be more common than the limited frequency of antitrust challenges may suggest. A. Douglas Melamed, Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal, 20 BERKELEY TECH. L.J. 1247, 1249 (2005).

The developing nature of the truncated condemnation rule for exclusion may create uncertainty that makes truncated proof of exclusion more difficult than truncated proof of collusion; this difference may eventually disappear.

To similar effect, suppose for purpose of argument that exclusionary conduct is more likely to have a plausible efficiency justification than potentially collusive agreements among rivals. If so, plain exclusion would be observed less frequently than naked collusion even absent the deterrent effect of the antitrust laws. But the initial supposition is no more than a hypothesis. It cannot be inferred from the observation that vertical non-price restraints have almost invariably been upheld by courts applying the rule of reason, for two reasons. First, defendant victories under the rule of reason frequently result from lack of proof of market power. Defendant success in such cases provides little guide to the likelihood that exclusionary conduct would be justified when defendants have market power, the setting in which exclusionary conduct has historically raised the greatest antitrust concern. Second, vertical restraints can harm competition through collusion as well as exclusion. Unless the relative frequency of collusive versus exclusionary competitive effects theories in such cases is strongly skewed, defendant success in such cases would not distinguish those theories.

That enforcement response would make sense unless plain exclusion is more harmful than naked collusion when each occurs, and if there is no greater problem with unreasonable (not plain) exclusion than with unreasonable (not naked) agreements among rivals.

See, e.g., WILLIAM J. BAUMOL, ROBERT E. LITAN & CARL J. SCHRAMM, GOOD
inappropriately tend to protect competitors not competition in exclusion cases (but not collusion cases).192

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, or that unsuccessful rivals can systematically convince the enforcement agencies and courts to accept bad cases.193 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.194 More than most firms, moreover, defendants in exclusion cases, particularly large firms like Microsoft, 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 budget. Large firm defendants in exclusion cases also tend to have the resources to make an effective public relations case and mobilize political support.

For these reasons, application of the error cost framework to contemporary antitrust rules does not justify treating exclusion as a lesser antitrust offense than collusion. That conclusion is not surprising given the close economic relationship between the mechanisms by which exclusion and collusion allow firms to exercise market power,195 and the similarity in the formal burdens that the courts place on plaintiffs seeking to prove harm to competition from exclusion and collusion.196

---


193 In addition, the antitrust injury requirement, introduced in 1977, 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).


195 See supra Section II.

196 See supra Section III.
V. 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 anticompetitive collusion should be rejected. Doing so 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. The major benefit of such a rhetorical shift would come from protecting the legitimacy of those rules against pressure for modifications that would limit enforcement. A shift may also heighten the salience of the open questions in the formulation of the rules governing truncated condemnation of anticompetitive exclusion, and thereby encourage the further development of the law in that area.

A rhetorical change of course would likely have only a modest effect on the number of exclusion cases brought by government agencies or private plaintiffs, even if government enforcers alter the way they describe their enforcement priorities. The relative frequency of government enforcement actions and private lawsuits of various types depends importantly on the relative frequency of the underlying anticompetitive conduct, and on the tools available to enforcers and plaintiffs for identifying them – neither of which would directly be affected if exclusion is no longer described as a lesser antitrust offense. Indeed, to the extent firms today have been mislead by the common rhetoric, and incorrectly believe that anticompetitive exclusionary conduct would not successfully be challenged, a change in that rhetoric could increase deterrence, reduce the prevalence of such conduct, and, in consequence, reduce the frequency with which it is challenged.

But a shift in how exclusion is viewed could matter for remedies by making the Justice Department more receptive to raising the penalties for anticompetitive exclusionary conduct through increased criminal enforcement. The Justice Department has the discretion to challenge anticompetitive exclusionary conduct as a civil violation or to prosecute it

---

197 See supra Section III.
198 See supra notes 148-60 and accompanying text.
criminally, in the same way that the government has the discretion to attack collusion civilly or criminally. Criminal enforcement has been employed in the past, for example in a monopolization case brought against a dominant newspaper and its senior officials alleging exclusionary conduct similar to the anticompetitive practices attacked in Lorain Journal. Today, however, criminal antitrust enforcement focuses on cartel conduct, 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 collusion. Under such circumstances, criminal prosecution of exclusionary conduct would almost surely be reserved for the most egregious cases of plain exclusion, in much the way that the government now targets only the most egregious naked cartels for indictment.


well as other criminal allegations) if a dominant firm harms competition by destroying its key rival’s factory,\textsuperscript{205} or if a price-fixing cartel engages in cooperative conduct to exclude an actual or potential rival that threatened to destabilize their collusive arrangement, but other types of plain exclusion could be prosecuted as well.

If antitrust rhetoric changes to describe exclusion as central to antitrust enforcement, enforcement attention may also shift toward preventing exclusionary conduct that forecloses potential entry in markets subject to rapid technological change.\textsuperscript{206} Enforcement against anticompetitive exclusion can be important for fostering innovation, investment and economic growth in monopolization\textsuperscript{207} and agreement cases,\textsuperscript{208} and in merger review.\textsuperscript{209} 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 majority’s nod toward monopoly power as a means of encouraging innovation,\textsuperscript{210} which risks leading lower courts astray.

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 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).

\textsuperscript{205} 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).


\textsuperscript{207} E.g. United States v. Microsoft Corp., 253 F.3d 34, 79 (D.C. Cir. 2001).

\textsuperscript{208} See, 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).


competition in similar ways and are treated comparably in the framing of antitrust rules. Nor do error cost considerations 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 that 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.