Refusals to Deal

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General Exclusion Standards

- Alternative Standards
  - Consumer Welfare Effect
  - Profit Sacrifice/No Economic Sense
- Benefits of CWE
  - Focused on goal of antitrust
  - Flexible – “an enquiry meet for the case”
  - Implies tailored structured inquiry for each type of exclusionary conduct
  - Unifies Section 1 and Section 2 analysis under the rule of reason
- Misperceptions about CWE standard
  - Does not require open-ended balancing – permits different specific legal tests in different exclusion settings
  - Does not lead to false positives
- Sacrifice/NES standard causes false negatives and false positives

Innovation Incentives

- Innovation incentives are a claimed rationale for restricting Section 2
- *But,* basis and significance of concern are unclear
  - Firms have strong incentives to innovate in competitive markets
  - Market innovation incentives improved by competition
  - Monopolists have weaker incentives than competitors
  - Exclusionary conduct reduces innovation incentives of entrants and rivals, by reducing or eliminating their market prospects
  - No evidence of weakened innovation from fear of antitrust
- Thus, justification for restricting Section 2 is weak

Comparing Standards for Refusals to Deal: Summary

- Alternative Standards
  - Consumer Welfare Effect
  - Profit-Sacrifice/No Economic Sense
  - Per Se Legality
- CWE and Sacrifice/NES have similarities
  - Both require a price benchmark
  - But, Sacrifice/NES standard may not require proof of anticompetitive effects (causes false positives)
- Per se legality leads to reduced competition and significant false negatives
  - Limits of per se rule also are unclear

Proposed Rule under CWE Standard: What Plaintiff Must Prove

- Monopoly power
  - Monopoly power in input market
  - Actual or likely monopoly power in output market

- Plaintiff has made a genuine offer to buy at or above the appropriate "non-exclusion benchmark" price, as defined below; whereas defendant has failed to accept such an offer or made a genuine offer to sell at or below that benchmark price. ("compensation" test)

- Refusal to deal would cause prices to be raised or maintained at supra-competitive level. ("effects test")
  - Output market
  - Input market
  - Another market where the entrant is an actual or potential competitor of defendant

Non-Exclusion Benchmark Price

- Non-exclusion benchmark price: potential alternatives
  - Prior price charged to plaintiff
  - Price charged to other buyers
  - Price that compensates defendant for monopoly profits on output sales lost to plaintiff ("protected-profits" benchmark)
- Potential adjustments to benchmark
  - If dealing raises defendant's production costs
  - If plaintiff creates reputational free riding
  - If monopoly power attained or maintained illegitimately
- Burden may shift to defendant to show plaintiff's price offer is below benchmark
  - If non-negotiable ("flat") refusal to deal

"Protected-Profits" Benchmark

- Properties of benchmark
  - Compensates for lost output market monopoly profits from defendant's customers who switch to entrant
  - But, no compensation for price competition caused by entry by firm with lower costs or superior product for some consumers
- Derived from ECPR literature
  - Baumol/Ordover/Willig
  - Commentators (e.g., Armstrong/Doyle/Vickers/White)
- Benchmark input price: $W = Cu + D \times Md$
  - Cu = monopolist's marginal cost of input (in dollars)
  - Md = monopolist's output "gross margin" over costs (in dollars)
  - D = fraction of entrant's output sales diverted from monopolist

Example: Verizon and AT&T

- Protected-profits benchmark is practical for courts and firms to calculate

- Assumptions: relevant data
  - Verizon's incremental cost of DSL inputs is *$10*
  - Verizon earns monopoly margin over costs of *$50* on retail DSL
  - If Verizon deals with AT&T, *50%* of AT&T DSL customers would come from Verizon retail DSL, with rest from cable and dial-up.
    - $D = 50\%$

- Benchmark input price: $W = \$35$
  - If $D=1$ (100% diversion), then $W=\$60$

Trinko's Cautions

- No general Sherman Act duty to deal
  - Cf *Colgate (no duty "in the absence of any purpose to create or maintain a monopoly")*
- Forced dealing raises red flags
  - Compelling firms to share may lessen investment incentives.
  - Enforced sharing requires courts to act as central planners
  - Compelling negotiation can facilitate collusion.

Investment Incentives Concern: Some Answers

- Benchmark price compensates defendant for monopoly profits on lost customers.
- Entrant unlikely to enter input market
  - Defendant’s input market monopoly power implies durable entry barriers
  - This also makes leapfrog competition by entrant less likely
- Competitive market will increase defendant’s innovation incentives
  - Monopolists have weaker innovation incentives
- Ability to enter output market will increase entrant’s innovation incentives
- Entrant cannot be called a free-rider on the grounds that it competes with defendant in only one market, rather than entering both markets
  - *Kodak (“this understanding of free-riding has no support in our case law”*)

Courts as Central Planners Concern: Some Answers

- Courts and agencies routinely compare prices and costs, and use other quantitative economic evidence
  - Eg, *Brooke Group, Ortho, Kraft,* agency merger analysis
- Task is not beyond the capabilities of District Court judges
  - Market prices often provide a good benchmark
  - Protected-profits benchmark is not too difficult to evaluate
- If antitrust withdraws, then alternative may be new public utility regulation
  - Is FOSC the next step?
    - **F**ederal **O**perating **S**ystem **C**ommission
  - Rare use of essential facilities doctrine could serves as an intermediate stopping point

Facilitating Collusion Concern: Some Answers

- Court's caution is very broad. Firms have independent incentives to negotiate, *and independent incentives to collude.*
  - Would Court's reasoning lead it to prohibit *voluntary* dealing between competitors because it can lead to collusion?
  - Or, prohibit joint ventures, which can (and sometimes do) serve as forums for collusion?
  - Or prohibit patent settlements, which can (and sometime are) used to strike non-compete agreements or collude on price?
- Refusals to deal against competitors may hide (or amount to) non-compete agreements:
  - ***"I will sell to you if you promise not to compete with me."***
- Collusion is less likely when negotiation is forced (and potentially monitored) by a court
- Incremental effect of forced negotiation on collusion likely insignificant or negative

How Would a Rule of Per Se Legality be Limited?

- If it is per se legal to refuse to deal with firms that compete with you ...
- Then why not also per se legal to refuse to deal with firms that ...
  - Sell output to your competitors? (“exclusive dealing”)
  - Purchase inputs from your competitors? (“exclusive dealing”)
  - Buy other products from your competitors? (“tying”)
  - Announce their intention to compete with you in some product market? (“non-competition agreement”)
  - Charge low prices for their competing products? (“price fixing”)

Appendix

The Overarching Antitrust Standard:

"Consumer Welfare" vs "Total Welfare"

Economic Welfare Standards

- True consumer welfare standard
  - *Consumer surplus*

- Total welfare standard
  - *Total surplus*
  - Bork named this “consumer welfare” -- deception or just confusion?

- Why use the ***true*** consumer welfare standard?
  - Does not permit *competitor injury* to trump *consumer benefits*
    - ***But, total welfare standard does allow this trump -- Did Bork know?***
  - Consistent with precedent
  - Simpler to evaluate *(price and output)*
  - Induces efficient conduct
    - Firm can marginally restructure transactions in efficient ways to eliminate consumer harm and raises total welfare in the process
    - Offsets unwillingness of courts/agencies to rigorously apply less restrictive alternative standard or gain full information about potential alternatives, thereby preventing inefficiencies
  - Better supports innovation incentives

Innovation Incentives and Welfare Standards

- Consumer welfare standard supports greater overall innovation incentives
  - Total welfare standard allows the dominant firm to destroy higher cost rivals that otherwise would innovate, thereby reducing innovation
  - Total welfare standard allows mergers and exclusion that eliminate competition, leading to a dominant firm with less incentive to innovate
  - These harms likely are larger than any marginal efficiency benefits from allowing mergers or exclusionary conduct that modestly reduce costs, while leading to higher prices to consumers
- Thus, adopting the true consumer welfare standard leads to higher long-run *total welfare*, as well as higher long-run *consumer welfare*.