Cheap Exclusion

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I. Introduction

Thank you for inviting me to address this Ninth Annual Conference. In a short time, this has become one of the premier events on the antitrust calendar, and I look forward to participating in it. Needless to say, the views expressed are mine alone and are not necessarily the views of the Commission or any individual Commissioner.

A central question for any law enforcement program is where to focus resources to best achieve the program's objectives. Now, the search for good merger cases is comparatively easy. Most problematic mergers walk right in the door, and they bring their documents with them. The Hart-Scott-Rodino Act[1] makes the first step in identifying anticompetitive mergers a reactive one and reduces initial search costs to close to zero.[2]

Nonmerger enforcement obviously requires a different approach. The size of the American economy and the range of conduct contained within it would make any notification program impossible. Under such circumstances, it becomes important to be able to identify particular patterns of behavior that are likely to result in the illegitimate acquisition or maintenance of market power. If we can identify such patterns, we can more efficiently allocate resources to target that conduct.

To identify such patterns, let me begin by distinguishing between two different types of potentially anticompetitive conduct. One type involves efforts by competitors jointly to raise price by reducing their *own* output – what I will here call "collusion." The other involves conduct by which firms exclude competitors from the market and effectively prevent those

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[1]Clayton Act § 7A, 45 U.S.C. § 18a.

[2]Of course, mergers that fall below HSR thresholds can also be anticompetitive, and the Commission allocates non-trivial resources searching for those acquisitions. Additionally, once the HSR filings are made, there are significant search costs in identifying the minority of acquisitions that are potentially anticompetitive.

excluded firms from expanding output, so that overall market output is reduced. Hereafter I will refer to such efforts as "exclusion." I would note that this distinction between "collusion" and "exclusion" does not quite match the distinction between Section 1 and Section 2,[3] because exclusionary conduct to reduce *others'* output may be undertaken either unilaterally or through agreement among rivals.

With respect to "collusive" conduct, the antitrust community long ago reached a consensus that certain types of agreements – to set prices, allocate customers, or divide sales territories – are inherently problematic. They are therefore an easy and obvious focus for antitrust enforcement efforts.

With respect to exclusionary conduct, however, no similar consensus has developed that there exists some set of "core" conduct that can be viewed as inherently problematic and to which enforcement resources should be directed. One possible explanation for this lack of any consensus is that there simply *is* no such conduct – that is, no forms of exclusionary conduct can be readily identified as anticompetitive without elaborate analysis. But another possible explanation is that our analysis of alleged exclusionary conduct typically has focused elsewhere – for example, on developing standards, such as the "profit sacrifice" test, that attempt to establish a single standard for separating anticompetitive exclusionary conduct from legitimate business behavior.

What I would like to do this morning is to suggest that it may be worthwhile attempting to consider whether it is possible as an aid to targeting good cases to identify some types of conduct as "naked" exclusion. If we could isolate conduct that is likely (assuming all other elements of an antitrust violation are made out) to have only anticompetitive effects, it would be an important step in helping prioritize our enforcement efforts.

Some additional benefits also might follow from reaching agreement regarding types of "naked" exclusionary conduct. To begin with, it may be an easier, albeit more modest, task than reaching agreement regarding the broader question of whether there is a single proper mode of analysis that should be used to distinguish exclusionary from legitimate business behavior. At least, that is one possible lesson that might be drawn from our collective experience with collusion. In that area, even decades after a consensus developed regarding forms of collusion that might be rejected *per se*, the lively commentary surrounding some of the Commission's recent decisions in cases such as *Schering*[4] and *Polygram*,[5] reflect the fact that the proper

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[3]Sherman Act §§ 1-2, 15 U.S.C. §§ 1-2.

[4]*Schering-Plough Corp. v. F.T.C.,* 402 F.3d 1056 (2005), *rev'g In re Schering-Plough Corp.,* Dkt. No. 9297, 2003 WL 22989651 (F.T.C. Dec 08, 2003) (Opinion), *available at* http://www.ftc.gov/os/adjpro/d9297/031218commissionopinion.pdf.

[5]*In re PolyGram Holding, Inc*., Dkt. No. 9298, 2003 WL 21770765 (F.T.C. Jul. 24, 2003) (Opinion), *available at* http://www.ftc.gov/os/2003/07/polygramopinion.pdf, *appeal docketed,*

Dkt. No. 03-1293 (D.C. Cir).

[6]*See*

[7] *In re Union Oil Company of California,* Dkt. No. 9305 (March 4, 2003) (Complaint), *available at*

[11] *See, e.g.,* Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts,* 65 Minn. L. Rev. 521 (1981), and the literature discussed therein.

[12] *Allied Tube & Conduit Corp. v. Indian Head, Inc.,* 486 U.S. 492 (1988).

arrangement, and with the terms that made the organization efficient for all its members and for the public.

As in *Unocal*, the conduct in Allied Tube also was “cheap” in the sense that it cost little, especially relative to the size of the profits that would accrue from acquiring market power. It cost Allied Tube only about $100,000 to recruit 155 new members, while other steel interests recruited and paid for the expenses of another 75 new votes. By contrast, the jury awarded $3.8 million in damages (before trebling). This high upside resulted in large part because the opportunism occurred in a setting where a handy source of durable market power already existed. Respected private standard-setting organizations often have the power to confer market power by choosing one party’s processes, or by excluding another’s – for example, as happened in *Allied Tube*, when the standard they set are routinely embodied in local building codes. In this setting, opportunistic behavior not only may be cheap to the excluding firms and inefficient in the marketplace, but may have great ability to inflict real harm to consumer welfare.

Just as standard-setting can provide a promising setting for the creation of durable market power, so too can misuse of government processes. The Commission’s Orange Book cases,

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[13] *United States v. Microsoft Corp.*, 253 F.3d 34, 76-77 (D.C. Cir. 2001).

[14] *Conwood Co. v. U.S. Tobacco Co.,* 290 F.3d 768 (6th Cir. 2002).

factory.

None of these acts can be explained in terms of the defendant's effort to increase output or improve product quality, innovation, or service. As intentional business torts, the behavior already has been recognized by societal consensus to be such that we want to discourage, not encourage. It is therefore "cheap" in the sense of "lacking any redeeming qualities." All of these acts also are "cheap" in the sense that they cost the firm engaging in them little in the way of expenditure. Tearing down a competitor's display rack may take less than a minute of an employee's time; lying to software developers costs even less. Indeed, we know from the fact that firms often engage in intentional torts against their competitors, that the conduct often will be viewed as profitable to the firm engaging in it, even when there is no prospect of gaining durable market power.

The fact that most intentional business torts do not contribute to monopoly power of course means that we should exercise extreme caution when claims of monopolization are raised. The antitrust plaintiff must prove that the alleged predator has acquired monopoly power and that the effect of the conduct is anticompetitive exclusion, not simply the imposition of costs on a competitor. That a competitor has been harmed may justify a tort suit by that competitor, if the other relevant elements of the tort are established, but to show an antitrust violation one must prove harm to competition. After all, firms are supposed to compete hard against their rivals, and antitrust must facilitate that, not deter it. But the point remains that when all the elements of monopolization, including injury to competition, are present, tortious conduct – rarely if ever an efficiency-enhancing form of "competition on the merits" – can be a cheap form of exclusion.

Because misuse of government processes, opportunism in standard-setting, and intentional torts lack any cognizable efficiency benefit, I would submit that they properly should be considered to constitute "naked" exclusionary conduct. And because they are also "cheap" in the sense of inexpensive to undertake, I submit that they are also likely to be – and the FTC's experience has shown them to be – relatively common. And that means our enforcement program should be especially tuned to them. The alternative hypothesis that I advanced at the beginning of these remarks, therefore, that we may not have previously labeled conduct as "naked" exclusion because there simply is no such type of conduct, is belied by the exclusion cases that the Commission has brought in recent years.

If "cheap" exclusion properly should be considered to be an important focus of enforcement efforts, let me conclude with three implications that might follow from that conclusion. First, examples of cheap predation suggest that there might be limits to the application of the "profit sacrifice" test as a necessary (rather than sufficient) standard for all forms of predation.

In determining whether conduct should be deemed exclusionary, it is often helpful to try to ascertain whether conduct should be deemed "economically irrational" but for its exclusionary effect – or, more narrowly, whether the conduct appears unprofitable (except for the profits gained by exclusion) . But profitability, economic rationality, or cost may not be very useful

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appropriate cases.

In conclusion, in our forthcoming article on cheap exclusion, which is co-authored by Bruce Hoffman, Tom Krattenmaker, and Ernie Nagata, we analogize our enforcement program to fishing. When fishing for exclusion, our notion has been that the best place to fish is where the fish are plentiful, and the things you catch are likely to be fish. Because we believe cheap exclusionary efforts are likely to be relatively plentiful, and are likely to lack any plausible efficiency justification, we have found it a useful part of the lake in which to dip in the line.