



Protect Competitors? Pity the Poor Monopolist? Antitrust Treatment of Refusals to Deal

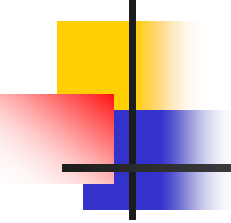
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Innovation Incentives and Antitrust Enforcement

- Innovation incentives are a claimed general rationale for restricting antitrust cases against Monopolists
 - “The ability to charge monopoly prices – at least for a short period – is what attracts “business acumen” in the first place.” *Trinko (2003)*
 - “The successful competitor, having been urged to compete, must not be turned upon when he wins.” *Alcoa (1945)*
- *But*, economic basis and significance of concern about monopolists’ innovation incentives are unclear
 - “Immunity from competition is a narcotic, and rivalry is a stimulant to industrial progress.” *Alcoa (1945)*
 - There is no evidence of weakened innovation incentives from fear of antitrust
- *Questions: What is the best middle ground (if any)?*



Application to Refusals to Deal: *Trinko's* Cautions

- *Trinko* (2003) – U.S. refusal to deal case
 - No general Sherman Act duty to deal, even by a monopolist
- “Forced” dealing raises red flags
 - Compelling negotiation can facilitate collusion.
 - Compelling firms to share may lessen investment incentives
 - Enforced sharing requires courts to act as central planners
- *Key question: At what price must monopolist sell?*
 - Would that price properly compensate “legitimate” monopolist?
 - Can courts determine that price in practice?



Non-Exclusion Benchmark Price: Potential Alternatives

- Marginal cost
 - Problematical since does not compensate legitimate monopolist for investment
- Market prices
 - Price previously charged to plaintiff (if prior voluntary dealing)
 - Price charged to other buyers (if sell to others)
 - Problematical if world has changed; or, if no prices exist.
- “Protected-Profits” price benchmark
 - Price that compensates defendant for monopoly profits on output sales lost to plaintiff

Properties of Protected-Profits Price Benchmark



- Derived from ECPR literature
 - Baumol/Ordover/Willig (fungible products)
 - Armstrong/Doyle/Vickers/White (differentiated products)
- Consistent with Profit-Sac/NES, EEE and CWE antitrust standards
- Protection of monopolist's property rights and innovation incentives
 - Compensates "legitimate" monopolist for lost output market monopoly profits from defendant's customers who switch to entrant
- Protection of competition
 - No compensation for incremental price competition caused by efficient entry by firm with lower costs or product preferred by some consumers
- Practicality
 - Already used in regulatory environment (fungible product case)
 - Requires limited information (defendant's price and costs; diversion ratio)



Calculating the Protected-Profits Benchmark

- Benchmark input price: $W = Cu + D \cdot Md$
 - Cu = monopolist's marginal cost of producing input (e.g., €10)
 - Md = monopolist's output (downstream) "gross margin" over costs (e.g., € 50)
 - D = fraction of entrant's output (downstream) sales diverted from monopolist (e.g., $D=1$ or $D=0.50$)
- Example: Fungible Products ($D=1$)
 - $W = €10 + 1 \cdot €50 = €60$
- Example: Differentiated Products ($D=0.50$)
 - $W = €10 + .50 \cdot €50 = €35$



Potential Refinements

- Non-negotiable (“flat”) refusals to deal
 - Burden shifts to defendant to show plaintiff made no price offers above benchmark
- Upward adjustments to benchmark price
 - If dealing raises defendant’s production costs; capacity limits
 - If plaintiff pursues reputational free riding
- Downward adjustments to benchmark price
 - If monopoly power attained or maintained “illegitimately”
 - If input is “essential facility” and court is willing to undertake a more refined balancing of incentives

Proposed Rule of Reason Legal Standard: What Plaintiff Must Prove

- Monopoly Power
 - Monopoly power in input market
 - Actual or likely monopoly power in output market
- Refusal to Deal
 - Plaintiff has made a genuine offer to buy at or above the appropriate “non-exclusion benchmark” price;
 - Whereas, defendant has failed to (i) accept such a genuine buy offer or (ii) make its own genuine sell offer at or below that benchmark price.
- Anticompetitive effects
 - Refusal to deal would cause prices to be raised or maintained at supra-competitive level in a relevant market, where the monopolist and entrant are actual or potential competitors
 - Output market
 - Input market
 - Adjacent market
- Defendant can rebut by showing sufficient offsetting cost/product quality/investment effects that cause *net* consumer benefit (on balance)
 - *Evidence must relate to specific impact on defendant going-forward, not a categorical presumption*



Impact on Investment Incentives

- Benchmark price protects legitimate monopolist's investment incentives
 - Compensates defendant for monopoly profits on lost customers, while permitting competition to occur.
- Leap-frog competition by entrant to enter input market would be unlikely in situations where this refusal to deal rule applies.
 - Defendant's has monopoly power *only if* there are durable entry barriers in the input market
- Market competition will increase innovation incentives
 - Monopolists have weaker incentives than competitors
 - Monopolists have stronger incentives when monopoly is being threatened with competition
 - Exclusionary conduct reduces innovation incentives of entrants and rivals, by reducing or eliminating their market prospects
- Labelling an entrant a free-rider simply because it competes with a defendant with proven monopoly power in only one market (rather than entering both markets) is an extreme view



Central Planning Concern

- Task is not beyond the capabilities of courts and agencies
 - Market prices often provide a good price benchmark
 - Courts and agencies routinely compare prices and costs, and use other quantitative economic evidence
 - Eg, Predatory pricing, bundled rebates, merger analysis
 - ECPR already used in regulatory context
- If antitrust withdraws, then next-best alternative may be full-fledged public utility regulation
 - Refusal to deal law by courts in these limited circumstances can serve as an episodic intervention short of full regulation



Finally, 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 ...
- Why not also *per se legal* for defendant to refuse to deal with firms that ...
 - Announce their intention to compete in some product market? (“non-competition agreement”)
 - Charge low prices for their competing products? (“price fixing”)
 - Buy other products from dfn’s competitors? (“tying”)
 - Sell output to dfn’s competitors? (“exclusive dealing”)
- Defendant’s “reputation” as substitute for “agreement”