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Unilateral Refusals to Deal and the Antitrust Modernization Commission Report

Keith N. Hylton*

(forthcoming, *The Antitrust Bulletin*, symposium
on the Antitrust Modernization Commission)

Abstract: The Antitrust Modernization Commission recommends that refusals to deal with rivals in the same market should rarely, if ever, be unlawful. I will focus on the principles that should determine the legal standard governing unilateral refusals to deal. A legal test that is strongly biased in favor of defendants, as the Commission recommends, is desirable as a default rule and especially in cases in which the essential facility at the core of the refusal to deal dispute is efficiency enhancing. However, there is another set of cases in which the defendant gains control of an essential market portal. In these cases, a legal test that is less biased toward defendants may be preferable to the Commission's suggested approach.

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On the subject of unilateral refusals to deal, the Antitrust Modernization Commission recommends that "refusals to deal with rivals in the same market should rarely, if ever, be unlawful under antitrust law, even for a monopolist."[1] The Commission concluded its report by endorsing

> the longstanding principle that, in general, firms have no duty to deal with a rival in the same market. To the extent that circumstances exist in which firms may be liable for a refusal to deal with a rival in the same market, the courts should further clarify those circumstances.[2]

The purpose of this essay is to take up the Commission's request for further clarification. Clarification could take one of two approaches. One is to set out rules, like the rules of a game, that a dominant firm would have to follow in order to avoid liability for refusing to deal.[3] The other approach would attempt to state a set of principles governing liability, leaving it to the courts to define the rules of the game through case law adjudication.

I will adopt the second approach here; that is, I will try to set out principles governing liability rather than rules governing conduct. I take this approach for the following reasons. First, I doubt that it is possible in this area of the law to set out a body of clear rules that would channel a dominant firm's conduct in a manner that would enable it to avoid liability with certainty. For example, if one states as a rule that a dominant firm should be immune from liability if it exploits its market position but not if it excludes a rival,[4] that merely forces a court to distinguish cases of exploitation from exclusion. The clarity provided by such a rule is temporary and largely illusory. Second, the biggest problem in the refusal to deal context is trying to set out principles, not rules guiding conduct.

The Commission report does not use the term "essential facility" in its discussion of refusals to deal, but I will use it at times below. Although the term has been the subject of criticism[5] and the Supreme Court has never recognized the essential facility doctrine as an independent theory of antitrust liability,[6] the concept remains useful in the area of refusals to deal. The cases involve firms that have market power, and often the source of that power is some property or entity that the defendant controls that provides it an enormous advantage in the market. The term essential facility makes it easier to describe the property that is at the core of the case.

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[1] Antitrust Modernization Comm'n Report and Recommendations 101 (2007), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

[2] *Id.* at 104.

[3] *See id.* at 104 & 115 nn.187-89.

[4] *Id.* at 104.

[5] Philip Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles,* 58 ANTITRUST L. J. 841 (1990).

[6] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 411 (2004).

I will argue here that a legal test that is strongly biased in favor of defendants, as the Commission recommends, is desirable as default rule and especially in cases in which the essential facility at the core of the refusal to deal dispute is efficiency enhancing. However, there is another set of cases in which the defendant gains control of an essential market portal. In these cases, a legal test that is less biased in favor of defendants may be preferable to the Commission's suggested approach.

The Law of Monopolization and Refusals to Deal

The Commission report describes the law on refusals to deal by relying on *Verizon Communications, Inc. v. Trinko*,[7] where the Court held that the defendant did not have a duty to deal with rivals. The Commission report notes that *Trinko* offered two reasons to distinguish the facts in that case from those of *Aspen v. Highlands*,[8] in which the Court required the defendant to deal with a rival. One was that the defendant in *Aspen* had exited a mutually beneficial joint marketing arrangement, while the defendant in *Trinko* did not have the previous experience of being in a joint venture with the plaintiff.[9] The other was that the defendant in *Aspen* had rejected an option to sell its service at retail price to the defendant, while the defendant in *Trinko* had not been presented with such an option.[10] As the Commission report notes, the Court did not spell out precisely what these distinctions would mean in future cases.[11] For example, it is not clear after *Trinko* whether a decision to exit a mutually beneficial joint venture would imply a violation of Section 2 on the part of the dominant firm.

A. General Standards

Looking generally at the case law on monopolization, two broad legal standards appear to have been adopted.[12] One is the *welfare balancing approach* introduced into to the law by Judge Learned Hand in *Alcoa*.[13] The other is the *specific intent approach* that existed in the monopolization case law before *Alcoa*.[14] In order to better understand the decision in *Trinko*, I think it is necessary to understand what these standards require in the refusal to deal setting, and how *Trinko* fits into these general approaches.

The balancing approach of *Alcoa* is easy to articulate. A dominant firm violates Section 2 of the Sherman Act if the procompetitive or efficiency defenses for its conduct are insufficient to outweigh the anticompetitive effects. Judge Hand did not describe the

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[7] *Id.*
[8] Aspen Skiing Co. v. Aspen Highlands Skiing Corp.**,** 472 U.S. 585 (1985).
[9] *Trinko*, 540 U.S. at 409 ("The complaint does not allege that Verizon voluntarily engaged in a course of dealing with its rivals, or would ever have done so absent statutory compulsion.").
[10] *Id*. at 410 (observing that unlike Aspen's lift tickets, Verizon's "services allegedly withheld are not otherwise marketed or available to the public").
[11] Antitrust Modernization Comm'n, supra note 1, at 101.
[12] KEITH N. HYLTON, ANTITRUST LAW: ECONOMIC THEORY AND COMMON LAW EVOLUTION 186-195 (2003).
[13] United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).
[14] HYLTON, supra note 12, at 186-188.

standard in precisely these terms in *Alcoa*. Hand's language was summarized in *United States v. Grinnell* as excusing the defendant from liability when the maintenance or acquisition of its monopoly position could be attributed to superior skill, foresight, and industry.[15] Excessively aggressive efforts to obtain or maintain the monopoly, efforts that could not be explained solely by efficiency, would be treated as conduct violating the standard. In *Alcoa*, the court found that the defendant violated the statute because its aggressive expansion and its preemptive enhancement of capacity made it difficult for rivals to enter the market and compete against it. In Hand's view, the aggressive expansion efforts of Alcoa could not be attributed entirely to superior foresight or industrial necessity; they reflected a determination to foreclose markets to rivals.

The language of *Alcoa* has undergone some evolution over the years. By the time of the *United Shoe*[16] decision the courts had begun to focus on exclusionary conduct rather than aggressive acquisition. As a signal to potential defendants of what sort of conduct might violate the law, the shift toward the term exclusion, rather than aggressive acquisition, was probably desirable. The term exclusion provides notice to potential defendants that they may violate the law by taking action that is designed to remove rivals from their markets. In contrast, the term "aggressive acquisition" has broader implications and could easily chill any efforts to expand a business.

The *Microsoft* decision[17] reveals another change in the language used by courts to describe the monopolization test. The balancing of anticompetitive effects against procompetitive benefits was implied by the test Judge Hand articulated in *Alcoa*. The test for monopolization was described explicitly as a balancing test in *Microsoft*:

> First, to be condemned as exclusionary, a monopolist's act must have an "anticompetitive effect."… Second, the plaintiff…must demonstrate that the monopolist's conduct indeed has the requisite anticompetitive effect…Third, if a plaintiff successfully establishes a prima facie case … then the monopolist must proffer a "procompetitive justification" for its conduct….Fourth, if the monopolist's procompetitive justification stands unrebutted, then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit.[18]

It should be clear that under the welfare balancing test, a dominant firm defendant could have a substantial efficiency justification for its conduct, and yet still be found in violation of the law. Of course, the precise method by which a court would balance anticompetitive effects against procompetitive benefits has never been explained. In theory, one could estimate the loss in consumer welfare from the defendant's conduct and

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[15] United States v. Grinnell Corp. 384 U.S. 563, 570-71 (1966) (holding that a company's "growth or development as a consequence of a superior product, business acumen, or historic accident" is distinct from an illegal monopoly).
[16] United States v. United Shoe Mach. Corp., 110 F.Supp. 295 (D. Mass. 1953).
[17] United States v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001).
[18] *Id.* at 58.

compare that amount to the gain in efficiency, as suggested by Oliver Williamson.[19] However, courts have not demanded litigants to frame their cases with such precision.

The specific intent approach was the predominant monopolization standard before the *Alcoa* decision, and is primarily responsible for the perception that Section 2 was ineffective until the *Alcoa* decision.[20] Under the specific intent standard, a dominant firm could be held liable under Section 2 only if the evidence supported the inference that its conduct had no significant procompetitive or efficiency justification, and that the sole or primary purpose of the conduct was to exclude a rival. Under the specific intent approach, a substantial efficiency justification would immunize the defendant from liability under Section 2.

There are modern versions of the specific intent approach that have been proposed by scholars. One is the profit sacrifice test, which seeks to determine whether the defendant's conduct would have been profitable if it did not have an exclusionary effect.[21] If not, then the defendant should be found liable. Another version of the specific intent approach is the no-economic-sense test, under which the defendant is liable under Section 2 if its conduct would not make economic sense unless it had an exclusionary effect.[22] Yet another version is the equally efficient competitor test, which holds the defendant liable only if its conduct would have excluded from its market an equally efficient competitor.[23]

Each version of the specific intent approach attempts to immunize the defendant for efficiency or procompetitive features of its conduct. The specific intent approaches would not allow a defendant to be held liable when the exclusionary effect of its conduct is primarily attributable to its efficiency characteristics.[24] Each of these tests avoids balancing efficiency justifications against anticompetitive effects.

B. *Trinko* Viewed as a Specific Intent Standard

With these two general standards in mind, specific intent and welfare balancing, we can return to the *Trinko* decision to determine which approach the Court adopted. Recall that the second distinction the Court drew between *Trinko* and *Aspen* was based on the pricing behavior: "In *Aspen Skiing*, the defendant turned down a proposal to sell at its own retail price, suggesting . . . that its future monopoly retail price would be higher. Verizon's reluctance to interconnect at the cost-based rate of compensation … tells us nothing about dreams of monopoly."[25]

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[19] Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968).
[20] See, e.g., HYLTON, supra note 12, at 188.
[21] A. Douglas Melamed, *Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals to Deal*, 20 BERKELEY TECH. L.J. 1247 (2005).
[22] Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2: The "No Economic Sense" Test*, 73 ANTITRUST L. J. 413 (2006).
[23] RICHARD A. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 194-95 (2d ed. 2001).
[24] Ronald A. Cass & Keith N. Hylton, *Antitrust Intent*, 74 S. CAL. L. REV. 657 (2001).
[25] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 409 (2004).

These statements have implications for the issue of antitrust intent. The refusal to sell at retail price does immediately raise a question of intent. Ordinarily, a firm makes at least a normal profit (i.e., recoups its costs, including opportunity costs) by selling at retail price, and would not turn down a retail customer unless the cost of the transaction is unusually high. Of the possible motivations behind a refusal to sell to a rival at retail price, the intention to injure the turned-down rival is a plausible one. The *Trinko* case is different because the reluctance to engage with a rival in a transaction that has a negative expected profit does not immediately raise the inference of an exclusionary motivation. It obviously reflects an unwillingness to suffer a cost in order to aid a rival. But it does not obviously suggest an intention to injure the rival. In other words, exclusionary intent is a highly plausible explanation for the conduct observed in *Aspen*.[26] In *Trinko*, the exclusionary motivation is greatly overshadowed by the more plausible self-interested cost minimization motive.

If the second distinction of *Trinko* is at the core of the Court's reasoning, then it suggests that the Court has adopted the specific intent test for refusals to deal (or dominant firm essential facility) cases. *Trinko* holds that a dominant firm cannot be found liable under Section 2 when its refusal to cooperate with a rival reflects merely a refusal to suffer a cost in order to aid or support the rival. The corollary of this proposition is that in order to find a violation of Section 2 when a dominant firm refuses to cooperate with a rival, one has to proffer evidence that indicates an intention to injure the rival. In other words, the facts have to suggest that of the available motivations, the intention to injure or exclude the rival is a highly plausible one.

Trinko rejects the balancing test of *Alcoa*. Under the balancing test, the court would compare the justifications offered by the defendant with the anticompetitive effects of its actions. In *Trinko*, the defendant did not have a substantial procompetitive justification. Almost any attempt to balance the (nonexistent) procompetitive justifications against the anticompetitive effect would have resulted in a decision against the defendant.

If we look at *Trinko* in terms of the big picture of Section 2 case law, it implies that the monopolization standard has splintered. Courts still refer to the general balancing test of *Alcoa* as the starting point for monopolization cases. But in the area of refusals to deal, *Trinko* suggests that the standard has changed and is effectively the specific intent test.

The tests I have described, welfare balancing and specific intent, are simply signals to courts on the proper allocation of evidentiary burdens. A court could easily apply the balancing test in a manner that is consistent with the specific intent approach by raising the burden of proof on the plaintiff. However, rather than remain with the same balancing test while altering the standard of proof for certain cases, antitrust courts have

[26] Of course, this does not mean that exclusion is the only plausible explanation for the refusal to deal. An alternative explanation for the refusal in *Aspen* is a desire on the part of Aspen Skiing not to allow its local rival Highlands to free ride on its investments. See George L. Priest & Jonathan Lewinsohn, Aspen Skiing: *Product Differentiation and Thwarting Free Riding as Monopolization, in* ANTITRUST STORIES 229, 238-42 (Eleanor M. Fox & Daniel A. Crane eds., 2007).

adopted different standards that have the same function. The specific intent test shifts the burden of proof against the plaintiff while the balancing test puts roughly similar burdens on both parties. The purpose for shifting the burden is to minimize the costs of erroneous decisions.

The question I would like to consider is the normative one of what standard should be applied to refusals to deal. If the standards are really signals to courts on the proper allocation of proof burdens, then the underlying reasons for those standards should be based on the relative costs of erroneous decisions in favor the plaintiff and in favor of the defendant. Any effort to determine relative error costs requires an examination of the economic justifications for the defendant's conduct and for prohibiting it.

Economics of Refusals to Deal and Antitrust Principles

In this part I will examine the economics of refusal to deal cases. The term essential facility is not used in the Commission report, but I will use it in this part in order to frame the cases. Most of the well known antitrust refusal to deal cases can be described as essential facility cases.

The profit generated by a refusal to deal can be attributed to two sources. One is efficiency. A refusal to deal may protect or enhance the efficiency of an essential facility controlled by the defendant, or the refusal may prevent some inefficient outcome in general. The other source is the creation of competition barriers. A refusal to deal may generate profits to the dominant firm by shielding it from competition from a rival. Let π represent the dominant firm's profits. Let v represent the benchmark competitive price for the dominant firm's output, which is equal to the marginal benefit to the consumer at the competitive level of output. Finally, let p represent the price and c represent the unit cost of the dominant firm's output. The sources of profit can be described by the following decomposition:[27]

$$\Delta\pi = (\Delta p - \Delta v) + (\Delta v - \Delta c) \tag{1}$$

In simpler terms, this expression says that the short run change in the dominant firm's profits, from a refusal to deal, can be traced to: (1) the enhancement of competition barriers, which increases the difference between the dominant firm's price and the competitive benchmark price; and (2) the enhancement of efficiency, which increases the difference between the competitive benchmark price (or product value) and the unit cost.

Using this profit decomposition approach, we can separate the refusal to deal cases into three categories. One category involves cases in which the refusal to deal is part of an effort to protect or enhance the efficiency of the essential facility. In terms of the decomposition approach, cases in this category involve refusals to deal that either improve the value or reduce the cost of the product, or prevent a reduction in value or increase in cost (i.e., $\Delta v - \Delta c > 0$). A second category of cases involves refusals that are

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[27] See Keith N. Hylton, *The Law and Economics of Monopolization Standards*, (Boston Univ. Sch. of Law Working Paper No. 08-18, 2008), *available at* http://ssrn.com/abstract=1131250.

designed to create or enhance barriers to competition. These refusals either lead to a reduction in the value of the product (the competitive benchmark price) to the consumer or an increase in the price charged to the consumer (i.e., $\Delta p - \Delta v > 0$). A third category of cases involve a combination of competition-barrier creating and efficiency protecting conduct. Causation is an important legal issue in the tradeoff cases in this third category.

Efficient Refusals to Deal

In cases where the underlying essential facility is efficient, refusals to deal can be understood as efforts to protect or to enhance the efficiency of the facility. The best example is *Associated Press v. United States*,[28] which involved a challenge to the membership rules governing the Associated Press (AP) news-sharing network. The network was efficient because it permitted a newspaper member of the network to simultaneously enhance the quality of a newspaper issue ($\Delta v > 0$) and reduce the cost of producing it ($\Delta c < 0$). Newspapers without access to the network were unable to offer the same quality of news at the price that AP members could offer. Of course, their presence still forced AP to share the efficiency gains with consumers. The United States brought suit to enjoin an AP bylaw that permitted an AP member to veto the membership application of a local rival.

In view of the function of the news-sharing network, the refusal to permit a new member could have been efficiency protecting. First, given that it is costly to create such a network, the rents earned through its creation may have been necessary to recoup development costs. Cost-reducing innovation gives the innovating firm a period in which it earns rents from the innovation, until competing firms are able to mimic it. The same process presumably was at work in the case of the AP network.

The second way in which the refusal to deal may have been efficiency protecting has to do with the incentives to contribute to the network. As a news-sharing network expands, it becomes easier for any member to free ride off the efforts of other members. The creators of such a network have an incentive to limit membership in order to prevent the dissipation of the network's efficiencies.

It follows that the potential costs of enjoining the AP membership bylaw are the loss in incentives to innovate and the reduction in the network's efficiency. The first leads to a loss in consumer welfare in the long run; the second to a loss in consumer welfare in the short run. These should be treated as false conviction costs.

Since the network was efficient, one might wonder what gain might come of requiring the network to open up to new members. Requiring new membership could lead to competition on a lower cost platform. The benefits of such competition would go directly to consumers. On the other hand, there is no guarantee that opening up

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[28] Associated Press v. United States, 326 U.S. 1 (1945). Associated Press involves concerted activity rather than unilateral conduct. Still, the case is useful in this discussion because I am focusing on the essential facility at the core of the dispute. The economic issues I consider here are the same whether the conduct is unilateral or concerted.

membership would have led to more vigorous competition on a lower cost platform. The result could have been *collusive entry*; where the new firms that join the network fix prices with their local incumbent network members. Indeed, given that local newspaper markets are not large enough to support numerous competitors, the likelihood of collusive entry would have been high. It is not clear that the welfare gains from opening entry to new members would add substantially to the gains generated by the creation of the network itself.

If we take *Associated Press* as a representative example of an efficient essential facility, the costs of opening access to the facility appear to be as great as and probably greater than the potential gains. Put another way, the false conviction costs of refusal to deal lawsuits, in connection with efficient essential facilities, are likely to be high relative to the false acquittal costs.

These arguments apply to *Aspen*, which is another case of an efficient essential facility. The joint marketing arrangement between Aspen and its smaller rival Highlands had the effect of enhancing the value of the service to consumers. In terms of the profit decomposition approach in (1), the joint-marketing arrangement led to $\Delta v - \Delta c > 0$, because the option of skiing all of the mountains owned by the two firms offered a superior skiing experience for long-stay customers (destination-area skiers).

The effects of the refusal to deal in *Aspen* are more complicated. The essential facility was the joint-marketing arrangement. It did not exist once Aspen refused to continue it with Highlands. One could think of a potential essential facility, which is the combined skiing experience over all of the mountains owned by the two firms. That potential facility could exist only when the two firms agreed to a joint venture, or when one of the firms took control over all of the mountains.

The refusal to deal could have been exclusionary if the sole purpose for it was to permit Aspen to raise prices to consumers in the short-stay ski market (the market consisting of local consumers who would visit the mountains for a day or two). If the refusal made Highlands unprofitable as a stand-alone business, Aspen could gain a monopoly in the short-stay market.

On the other hand, the refusal to deal in *Aspen* could have been efficiency protecting if it supported the incentives of both parties to make optimal investments to enhance and maintain their private facilities. In the same sense, any refusal to share property with a trespasser can be treated as efficiency protecting because it supports incentives to invest in the property. A rule requiring property owners to share land with trespassers would diminish incentives to invest in real property.

Aspen was the larger firm and owned three of the four mountains in the area. Its investments were responsible for the majority of long-stay visitors to the mountains. For a joint venture between the two firms to be mutually beneficial, it would have to be on terms that permitted Aspen to recoup the costs and to exploit the productivity of its investments.

The key reason for the termination of the joint venture in *Aspen* was Aspen's refusal to accept a revenue sharing agreement based on an audit of customer usage of the mountains. But a revenue sharing agreement based on usage would fail to reward Aspen for the productivity of its investments, and would permit Highlands to earn a windfall.

Aspen is similar to *Associated Press* when one examines the false conviction and false acquittal costs. False conviction costs in *Aspen* can be identified as the diminished investment incentives that a sharing requirement would have on Aspen; and conversely the encouragement of parasitic deal making to Highlands. If Highlands enjoyed a windfall from the joint venture, it would have no incentive to reduce the amount it demanded from the revenue sharing agreement as long as Aspen could not legally exit the joint marketing relationship.

The false acquittal costs in *Aspen* are the welfare losses to long-stay consumers denied access to the joint marketing product, and to short-stay consumers who would no longer benefit from competition between Aspen and Highlands in the short-stay market. But the first cost is only a short term cost, because in the long term the joint marketing product could be kept on the market only under a mutually beneficial contract between the two firms. The second cost is not entirely a cost to society because it reflects the loss in Highlands' appeal when no longer subsidized by Aspen. To the extent rents were transferred from Aspen to Highlands to support a local duopoly in the short-stay market, the termination of those transfers is equivalent to the termination of a subsidy to the weaker firm. If consumers enjoyed a greater benefit from the duopoly before rather than after the termination, part of that benefit would have to be recognized as a transfer from Aspen.

Refusals to Deal as Competition Barriers

There are cases in which the profit resulting to the defendants from the refusal to deal is due to the creation of entry barriers. In *American Tobacco Growers v. Neal*,[29] the defendants were given the power to regulate tobacco warehouse sales and used it to block the plaintiff's access to the sales. The underlying essential facility, access to sales, provided no reduction in costs or increase in value. The defendants did not alter the value of the output to the consumer or reduce the cost of supply. They controlled an essential *market portal*, a point of entry that was necessary for rivals to enter to be able to compete with them.

The profits from the refusal to deal in *American Tobacco Growers* were due to the exclusionary effect of the refusal. In terms of the profit-decomposition approach in (1), the change in profits from the defendants' refusal to deal were the result of the higher prices that the defendants could charge when shielded from competition with the plaintiff. The refusal did not, at least in the short run, alter the quality of the output ($\Delta v =$

[29] Am. Fed'n of Tobacco Growers v. Neal, 183 F.2d 869 (4th Cir. 1950). Although this is another case involving concerted rather than unilateral conduct, it is useful for this discussion because I am focusing on the nature of the essential facility.

0), though the long term effect of shielding the defendants from competition probably would have been a weakening of their incentives to improve the quality of their tobacco ($\Delta v < 0$). The refusal did not serve to protect the efficiency of the warehouse sales. There was no evidence that the addition of another firm would adversely affect the operation of the auctions ($\Delta c = 0$).

While it is true that the addition of the plaintiff would reduce the rents earned by the incumbent firms, that should not be considered a welfare loss. The rents were not necessary to induce the firms to create a cost-reducing or value-increasing facility. Indeed, allowing the defendants to hold onto the rents earned through exclusion would have the undesirable long term effect of encouraging firms to gain control over market portals as a monopolizing tactic.

Looking at *American Tobacco Growers* from the error cost perspective, the case can be distinguished from *Associated Press* in terms of the balance of false conviction and false acquittal costs. If we regard access to the market portal to be the essential facility in *American Tobacco Growers*, the false convictions costs are relatively small because of the absence of efficiency justifications. In contrast, the efficiency justifications for the essential facility in *Associated Press,* the news-sharing network, were substantial and obvious. This implies that the false conviction costs suggested by *Associated Press* are substantially greater than those suggested by *American Tobacco Growers*.

The false acquittal costs in *American Tobacco Growers* also appear to be different from those in *Associated Press*. In *Associated Press,* the false acquittal costs are the welfare gains that might have been realized as a result of enhanced competition within the news-sharing network. But this prospect for enhanced competition was unclear, given the risk of shirking and free riding, and the risk of collusive entry. In contrast, the false acquittal costs in *American Tobacco Growers* consist of two components: the consumer welfare from enhanced competition within the warehouse system (that would be lost as a result of an acquittal), and the incentive to similarly-positioned actors to acquire market portals for exclusionary purposes. As in the case of *Associated Press*, it is hard to say a priori whether the entry of one firm would have produced a net gain to consumers given the risk of collusive entry. However, as additional firms joined the warehouse, more competition would eventually result. In comparison, such a conclusion would not be clear in *Associated Press* given the natural monopoly (or oligopoly) characteristics of local newspaper markets. This implies that the first component of the false acquittal cost, the potential gain to consumers, is smaller in *Associated Press* than in *American Tobacco Growers*. In addition, the second component of the false acquittal cost, the encouragement of rent-seeking, is obviously an important concern in *American Tobacco Growers*.

Legal Standard

Now I will consider the implications of this argument for the appropriate legal test for refusals to deal. In general, the specific intent approach is preferable when the ratio of false conviction to false acquittal costs is relatively high. Thus, in the case of an efficient essential facility, the specific intent test is appropriate. The reason is that the specific intent test reduces the risk of false convictions relative to the welfare balancing test. And since false convictions are likely to be more costly than false acquittals in a case like *Associated Press*, the specific intent approach is preferable.

It follows that the approach of *Trinko* should be applied to cases in the efficient category, such as *Associated Press* and *Aspen*. This implies that any impairment in efficiency (e.g., an increase in operating costs) to members in the *Associated Press* network should serve as an excuse for a refusal to deal. A violation of the monopolization standard should be inferred only when the evidence indicates that the primary or sole purpose for the refusal to deal was to exclude the rival. A refusal to suffer a cost in order to aid a rival should not be considered a violation of the legal standard.

In the case of a market portal essential facility, the foregoing analysis implies a different approach to the standard, or a different standard. Since the ratio of false conviction to false acquittal costs is not obviously high, the welfare balancing standard may be preferable to the specific intent standard.

To reduce this to a concrete case, return to *American Tobacco Growers*. Under the specific intent standard of *Trinko*, any significant increase in operating costs could be used by the defendants as a justification for their refusal to deal. Such a rule might lead to an undesirable outcome in a case like *American Tobacco Growers*.

The defendants in *American Tobacco Growers* could have pointed to, and in fact did point to, several costs that they would bear as a result of letting the plaintiff into the warehouse sales. The defendants noted that the plaintiff, because he was located outside of city bounds, was subject to lower taxes, fewer restrictions, and lower property costs.[30] From the defendant's perspective, it was reasonable to exclude the plaintiff because he would have operated with lower costs, and his business would have expanded relative to theirs because of access to the warehouse system. In addition, the defendants could have pointed to the need to schedule time for the plaintiff in the warehouses, which would have been a cost associated with admitting the plaintiff. The defendants had conceded that there was ample time to schedule the plaintiff without impairing their allotments of time.[31] However, the mere cost of coordinating and scheduling could have been asserted by the defendants as a cost of dealing with the plaintiff.

If we examine the defendants' arguments (both real and possible) in *American Tobacco Growers* under the specific intent approach of *Trinko*, it is not immediately clear that they would have been rejected. The defendants' arguments should have been rejected because they fail to identify a substantial cost or impairment in efficiency for the defendants. But the difficulty is that a court might find that the defendants' arguments do in fact identify a substantial cost or impairment under the analysis of *Trinko*. For example, a court might find that the mere cost of coordinating and scheduling the plaintiff should be taken as a sufficient justification for the decision to exclude the plaintiff from access.

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[30] *Id.* at 871.
[31] *Id.*

As this argument suggests, the risk of error has to be taken into account at the level of application of the standard. The specific intent standard appears best when the ratio of false conviction costs to false acquittal costs is high. However, the specific intent test is not error free. Errors can and will occur under any legal standard. The best test is one that leads to the least costly errors in expectation.

The specific intent test of *Trinko* could generate the right conclusion in *American Tobacco Growers*, and would if it were applied in an error free manner. But in view of the risk that the standard could result in acquittal in instances in which the exclusion is almost surely anticompetitive, the specific intent test may be less desirable than the welfare balancing test.

Consider the welfare balancing test in the case of *American Tobacco Growers*. Under this approach, the defendants could offer the same justifications examined above. Consider, for example, the justification that the defendants excluded the plaintiff because they did not want to suffer the cost of coordinating and scheduling the plaintiff's warehouse time, even though there was time that could be allocated to the plaintiff without diminishing the time allotments to the defendants. Under the welfare balancing test, this defense would have to be weighed against the consumer welfare gains of enhanced competition within the warehouse system. In one particular instance, the welfare gains from entry may seem small. As a general proposition, however, the welfare gains from entry are substantial. The welfare balancing test would suggest that, in general, the consumer welfare gains from entry outweigh the scheduling and coordination costs of the defendants – unless the defendants could produce evidence demonstrating that the coordination and scheduling costs were large.

The implications of these cases can be generalized. In efficient essential facility cases, refusals to deal should be examined under the specific intent standard implied by *Trinko*. The efficient essential facility cases include examples such as *Associated Press*, where the facility is the product of joint investments by a group of firms. This category also includes cases in which the defendant has developed an infrastructure, such as an electricity transmission grid, that reduces the cost of supplying consumers. The other broad category of essential facility cases involves market portals. In market portal cases, such as *American Tobacco Growers* and (perhaps) *Terminal Railroad,*[32] refusals to deal should be examined under the welfare balancing test, as articulated in *Microsoft*.

I have so far assumed that it is easy to distinguish efficient essential facility cases from market portal cases. The fact that it may not be easy suggests that a general preference for the specific intent standard, in the context of refusals to deal, would be preferable. In free-entry markets for acquisition or development of an essential facility, the presumption should be that any such facility is efficient. In government regulation settings, such as that observed in *American Tobacco Growers*, the presumption of efficiency would not be appropriate.

[32] United States v. Terminal R. R. Ass'n of St. Louis, 224 U.S. 383 (1912).

Suppose the conduct of the defendant involves several acts, some of which are exclusionary and others efficiency enhancing? Should the combination of defendants' actions be considered under the specific intent standard or under the welfare balancing test?

For the mixed cases, courts should apply the appropriate standard to each act. The more important issue is the causation standard. The *Microsoft* decision suggested that the causation test should not stand as a serious barrier to plaintiffs in monopolization cases.[33] If error costs are taken seriously, however, causation should be carefully analyzed in monopolization cases. If the underlying essential facility is efficient – such as the Windows operating system – acts designed to exclude access to that system should be analyzed under the specific intent standard as a default rule. The welfare balancing test should be applied only if the purely exclusionary acts – that is, the acts that could not be attributed to the protection of the facility's efficiency – could be considered sufficiently effective to explain or account for the plaintiff's injury.

Conclusion

The Commission's conclusion that refusals to deal should rarely if ever be unlawful is a useful guiding principle for courts, and the right approach as a default rule. However, when error costs are examined, a more detailed set of principles emerge. The legal standard governing refusals to deal should depend upon the efficiency properties of the essential facility at the core of the dispute.

[33] United States v. Microsoft Corp., 253 F.3d 34, 79 (D.C. Cir. 2001).