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Shaping Antitrust Enforcement: Greater Emphasis on Barriers to Entry

*David L. White**

I. Introduction

The topic of barriers to entry has been described as "crucial to antitrust debate," yet "badly misunderstood."[1] Although occasionally appearing within economic literature, entry barriers receive little attention from legal scholars. However, modern antitrust jurisprudence suggests that relative ease of entry into markets plays an increasing and very important role in assessing charges of anticompetitive conduct.[2]

This article explores various aspects of the subject of entry barriers that should influence antitrust formulations. Although not beginning to cover every intricacy connected with entry issues, the following material may offer a preview of the courts' anticipated advancement from a superficial or introductory consideration of this antitrust notion.[3]

As will be seen, courts must premise the ultimate resolution of questions on entry upon more than economic theory.[4] Conduct in individual cases, specifically including corporate strate-

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1. R. Bork, The Antitrust Paradox 310, 328 (1978). As that author further opines, "it will remain impossible to make antitrust law more rational" until "the concept of barriers to entry is thoroughly revised." *Id.* at 310.

2. Ball Memorial Hosp., Inc. v. Mutual Hosp. Ins., Inc., 784 F.2d 1325, 1336 (7th Cir. 1986) ("it is usually best to derive market share *from* ability to exclude other sources of supply"); United States v. Federal Communications Comm'n, 652 F.2d 72, 106 (D.C. Cir. 1980) ("Freedom of entry is the single most important guarantor of competition in a concentrated industry"); Miller, *Do Economies of Scale Attract Entry?*, 25 Antitrust Bulletin 583, 583 (1980); Salop, *Measuring Ease of Entry*, 31 Antitrust Bulletin 551, 553 (1986) (examination of ease of entry is "new to antitrust").

3. Ordover & Wall, *Proving Entry Barriers: A Practical Guide to the Economics of New Entry*, Antitrust, Winter 1988, at 12 (courts "are further ahead in recognizing that entry analysis is important than they are in understanding or articulating the dimensions of that analysis").

4. This is not to say that economic analysis is not invaluable to this subject. *See* Ordover & Wall, *supra* note 3, at 12.

gies and firm performances[5], should shape judicial determinations as much as industry structure.

II. Role of Entry Barriers in Antitrust Enforcement

What is meant by "entry barriers" or "ease of entry," and more importantly, why are barriers relevant in constructing and applying antitrust principles? Somewhat surprisingly, there are no uniform definitions in this area.[6] One might think of barriers to entry as determined by the highest product price possible without bringing new entrants into a market. Barriers alternatively can be viewed as costs of production faced by a firm seeking entry but which are not experienced by those already in the industry.[7] These barriers are then factors that make entry less profitable and allow established firms to set prices above marginal costs in order to receive greater than normal returns.[8] The disadvantages to which potential entrants are exposed do not emanate directly from smaller size or lesser resources, but rather from the fact and expense of entry itself. The focus is upon surcharges for joining the market and not merely upon the costs in creating a new business.

The foregoing definitions or descriptions are further understood by appreciating the significance of potential competitors for a marketplace. To begin, assume a single seller of a product is considering a hike in its sales price because of the lack of actual rivals in its geographic area. The company may resist such a temptation to price above a level yielding but normal profits out of a fear that others will enter the market as competitors. This

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5. *See generally* B. Baysinger, R. Meiners & C. Zeithaml, Barriers To Corporate Growth (1981) [hereinafter Barriers]; G. Yip, Barriers To Entry: A Corporate-Strategy Perspective (1982).

6. W. Baumol, J. Panzar & R. Willig, Contestable Markets and the Theory of Industry Structure 5, 282 (1982) [hereinafter Contestable Markets]; R. Bork, *supra* note 1, at 310; Demsetz, *Barriers to Entry*, 72 Am. Econ. Rev. 47, 48 (1982).

7. G. Stigler, The Organization of Industry 67 (1968) ("A barrier to entry may be defined as a cost of producing . . . which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry."). Freedom of entry thus does not indicate that making a presence is easy or without expense, but only that the entrant suffers no discriminatory costs. Baumol, *Contestable Markets: An Uprising In The Theory of Industry Structure*, 72 Am. Econ. Rev. 1, 3 (1982).

8. *In re* Air Passenger Computer Reservations Systems, 694 F. Supp. 1443, 1454 (C.D. Cal. 1988). Conditions of entry, reflecting the extent to which incumbents can elevate their selling prices over average costs without inducing possible entrants, thereby essentially mirror the state of potential competition. J. Bain, Barriers To New Competition 3 (1967).

sole purveyor has no monopoly power if others can promptly and readily enter the fray. In these situations the judiciary has little need to invoke the monopolization provisions of section 2 of the Sherman Act.[9]

Taking the illustration further, consider the product as being sold by oligopolists. With factors that allow or facilitate new entry, why anticipate other than competitive prices even though the market is populated by only a few firms? Why establish a cartel to seek controlled and elevated prices if the time and expense of so acting is met by a new entrant undercutting those collective charges? If new firms can freely enter, the courts need not invoke antitrust mechanisms to control oligopolies.

A judicial focus on costs rather than pricing reveals the same phenomena. If a monopolist or members of a cartel are inattentive or uncaring as to the costs in selling their products, those having easy entrance into the market can effectively compete with the use of more efficient operations. Newcomers thereby can compete without even needing to introduce price cuts. Similarly, if older firms tend to be conservative or otherwise generally unreceptive to innovation, progressiveness through the efforts of newcomers in supplying new goods or processes could be rewarded by the consumer.[10] These market models break down, however, when barriers to entry prevent entrance of newcomers. If barriers to entry are minimized by market forces or by vigorous enforcement of the antitrust laws, consumers are benefitted.

The impact on antitrust analysis that arises from these examples is larger than might initially appear. Antitrust practitioners know that entry barriers historically shape the law on many specific practices. A large manufacturer of copying machines could require users to buy only its make of paper—a tying arrangement. A legal concern is that entry barriers are thereby raised as those in the paper industry are foreclosed unless they also begin to build or otherwise obtain copying equip-

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9. *See* Cargill, Inc. v. Monfort, Inc., 479 U.S. 104, 119 n.15 (1986); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 591-92 n.15 (1986); Oahu Gas Serv. v. Pacific Resources, Inc., 838 F.2d 360, 366-67 (9th Cir. 1988), *cert. denied*, 109 S. Ct. 180 (1988); Metro Mobile CTS, Inc. v. Newvector Communications, Inc., 661 F. Supp. 1504, 1522-1523 (D. Ariz. 1987).

10. F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 377 (1970) ("There is abundant evidence . . . that actual and potential new entrants play a crucial role in stimulating technical progress, both as direct sources of innovation and as spurs to existing industry members.").

ment.[11] Moreover, suppose the same manufacturer uses exclusive dealing contracts to forbid major dealers from selling other copying machines. Other or new competitors could face entry barriers as important distribution outlets disappear.

However, these and other particularized forms of exclusionary conduct are not isolated or discrete occurrences where entry barriers are material to antitrust policy. Rule of reason cases under section 1 of the Sherman Act are continually referencing a threshold requirement of market power.[12] If plaintiffs cannot meet this initial hurdle of demonstrating power "to raise prices or limit output," their causes of action are often extinguished by the courts. If ease of entry by potential competitors does not allow a cartel to control rates or production, then the cartel does not possess the requisite power to justify an antitrust action.[13]

The belief of some commentators that almost any entry barrier is surmountable adds to this discussion of entry issues.[14] Their position is that excessive profits, or inefficiencies leading to inflated costs, will always invite entrance. Viewed somewhat differently, it is not sensible for an established firm to erect artificial barriers since those efforts are unproductive costs which aid the potential competitor.[15] Overreaching will merely spur newcomers. If "barriers" are instead generated through the use of greater efficiencies by existing firms, the activity should be applauded rather than condemned through an antitrust lawsuit. Under this scenario, any other barriers would not result from existing firms, and therefore should not be chargeable to them under the antitrust laws.

In short, there is no reason for any legal interference which would only alter normal competitive forces. Barriers precluding

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11. Construction Aggregate Transp. v. Florida Rock Indus., 710 F.2d 752, 780-81 nn.52-53 (11th Cir. 1983); Hirsh v. Martindale-Hubbell, Inc., 674 F.2d 1343, 1349 (9th Cir. 1982), *cert. denied*, 459 U.S. 973 (1982).

12. Ryko Mfg. Co. v. Eden Servs., 823 F.2d 1215, 1231 (8th Cir. 1987), *cert. denied*, 108 S.Ct. 751 (1988); Valley Liquors, Inc. v. Renfield Importers Ltd., 822 F.2d 656, 666-67 (7th Cir. 1987), *cert. denied*, 108 S. Ct. 488 (1987); Hand v. Central Transp., Inc., 779 F.2d 8, 11 (6th Cir. 1985).

13. *See* Ball Memorial Hosp. v. Mutual Hosp. Ins., Inc., 784 F.2d 1325, 1334-36 (7th Cir. 1986); Landes & Posner, *Market Power In Antitrust Cases*, 94 HARV. L. REV. 937, 950 (1981).

14. *See generally* R. BORK, *supra* note 1, at 310-28.

15. Federal Trade Comm'n v. Occidental Petroleum Corp., 1986-1 Trade Cas. (CCH) ¶ 67,071, at 62,513, 62,518 (D.D.C. 1986). *See also* Baumol & Willig, *Fixed Costs, Sunk Costs, Entry Barriers and Sustainability of Monopoly*, 96 J. OF ECON. 405, 421-24 (1981) (erection of barriers can be costly and insufficient).

new competition are merely a product of efficiencies that properly dissuade entry. To prevent such barriers is senseless and ineffective under rational economic theory. As a result, any exercisable market power is not improper over the long run. Antitrust enforcement is but a misguided meddling with the natural workings of markets. An assessment of the merits of this theme requires an appreciation of the particulars associated with entry barriers.

III. Sources of Barriers

Many factors might stop or retard entrance into a market. These "barriers" to entry include both natural and artificial barriers. Natural barriers arise from natural economic phenomena independent of the intentions or specific actions of incumbent competitors. Artificial barriers, on the other hand, result from the direct actions of incumbent competitors or interested outside sources. Varied reasons well beyond economic theory could further cause existing sellers not to fear or even see potential competitors poised on the edge of a marketplace.

A. Natural Barriers

1. In general

Many courts overlook two common grounds for staying out of a market. First, competitive acts of existing businesses dissuade newcomers from entering the market. The absence of more than normal returns of profit to efficient sellers tells prospective businessmen to consider another product, service or geographic area.[16] Second, specific firms may remain away from a market merely as a matter of free choice. Such entities could have greater interests or incentives elsewhere. In a sense, these non-entrants face no barriers at all.

Alternatively, a firm may wish to enter a market but may encounter natural, albeit very real, barriers to entry.[17] For example, company leaders may fail to seize profit opportunities be-

16. That competitive pricing might be caused, in part, by the presence of other potential entrants. A candidate for entry will normally analyze the likely behavior of those potential entrants over time when assessing his anticipated success with coming into the market. Caves & Porter, *From Entry Barriers to Mobility Barriers: Conjectural Decisions and Contrived Deterrence to New Competition*, 91 J. of Econ. 241, 242, 244 (1977).

17. Barriers, *supra* note 5, at 20-21.

cause of managerial deficiencies such as limits on education, ability, experience or foresight.[18]

Natural barriers might also arise from factors apart from such characteristics of any specific candidate for entry. Technological advantages could permit incumbents to operate with fewer means of production, or pecuniary advantages allowing for the employment of cheaper resources.[19] Such inhibitors are customarily referred to as absolute-cost barriers or scale-economy barriers.

2. *Absolute cost barriers*

Absolute cost disadvantages dictate that entrants obtain production requirements at higher costs or lower quality than they would face as existing competitors. Thus, the expected unit costs of production for potential entrants are, at essentially any common scale of operations, higher than those of established firms. Accordingly, the long-run average cost curve of the new firm will be above that of a going concern, since firms experience cost disadvantages at any chosen level of output.[20]

These cost differences normally occur because the entrant must use inferior methods of production or pay greater prices for labor and materials. For example, established firms control superior production techniques or essential resources that are offered to newcomers only at a premium.

Another illustration of an absolute-cost barrier is the cost of capital. A newcomer, unlike ongoing concerns in the market, may find funding very difficult.[21] The entrant may need greater amounts of capital, find funds more difficult to obtain, and find

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18. Federal Trade Comm'n v. Warner Communications, Inc., 742 F.2d 1156, 1163 (9th Cir. 1984); Allen-Myland, Inc. v. Intern. Bus. Machs. Corp., 693 F. Supp. 262, 279 n.35 (E.D. Pa. 1988).

19. BARRIERS, *supra* note 5, at 27-28.

20. R. CAVES, AMERICAN INDUSTRY: STRUCTURE, CONDUCT, PERFORMANCE 26, 27 (2d ed. 1967). *See also* Will v. Comprehensive Accounting Corp., 776 F.2d 665, 672-73 (7th Cir. 1985).

21. A requirement such as seven hundred thousand dollars in capital may or may not represent a large sum or barrier. This depends upon such factors as the nature of the business, demand levels for the industry, anticipated revenues, and the leverage of a new entrant. A large and diversified company, successful in other markets, may find the relative capital costs of entry to not be as serious an obstacle. Secondly, the focus is not upon the absolute size of the funding, but whether the newcomer is forced to pay more than an established firm to attract the investment. Finally, the amount of capital and resultant cost must relate to the size requirements for efficient entry upon reasonable evaluations by management for the newcomer and those in the markets.

the effective borrowing costs significantly higher than for existing firms.[22] The uncertainties and risks of a new venture, and the heavy promotion and other costs of catching up to established members of the industry, can easily limit funding avenues or demand a disproportionately high cost for access to funding.[23]

3. *Scale-economy barriers*

Scale-economy barriers occur if entrants do not obtain the lowest possible costs of production until they occupy a significant portion of the relevant market. In such settings the newcomer confronts a major dilemma.[24] If a newcomer invests enough to achieve the available economies of scale, to at least match incumbents' costs, the newcomer must take a significant part of the market from others. This requires a particularly large investment with a threat of heavy losses, especially in the short term, unless the newcomer cuts the market shares of existing market participants. Furthermore, the sales level needed to reach cost equality with incumbents may be high enough that the extra capacity introduced by the entrant will have the effect of reducing prices for all in the market.[25] Although the previous prices might have been profitable or acceptable for the entrant, that might not be true at the new price level. The alternative is no less appealing. An entrant could make a more limited investment and target a lesser impact on the market, but would pay a penalty for inefficiently operating on a small scale. Either choice requires newcomers to address disadvantages not confronted by older rivals.

Two elements or measures then define whether scale economies create a high or low barrier to entry into a given industry.[26]

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22. *See* United States v. Federal Communications Comm'n, 652 F.2d 72, 101 n.129 (D.C. Cir. 1980). The effective interest rate includes opportunity costs when working with lenders or investors, as well as contractual and other expenses for obtaining the capital.

23. *See* 2 P. Areeda & D. Turner, Antitrust Law ¶ 409e, at 303-05 (1980).

24. R. Caves, *supra* note 20, at 24-25.

25. This difficulty can be exacerbated if competitors have built capacity or scale ahead of demand. Contrarily, high utilization of capacity in an industry characterized by growing or a very elastic demand may make a newcomer's decision easier.

26. *See* Federal Trade Comm'n v. Owens-Illinois, Inc., 681 F.Supp. 27, 51 (D.D.C. 1988), *vacated*, 850 F.2d 694 (D.C. Cir. 1988); Federal Trade Comm'n v. Tenneco, Inc., 433 F. Supp. 105, 111 (D.D.C. 1977). The Merger Guidelines of the U.S. Department of Justice recognize that entry is hindered by "the need to achieve a substantial market share in order to realize important economics of scale." 4 Trade Reg. Rep. (CCH) ¶ 13,103, at 20,562 n.21 (June 14, 1984).

First, the larger the output of the firm reaching scale economies, compared to the total market, the more difficult it is to begin at an efficient size. Second, the greater the unit cost disadvantage of the small firm, the more difficult it is to begin at a small, inoffensive scale and compete successfully. The advantages to established firms are greater, and the conditions to entry made more difficult as the optimal scale of the new firm becomes large relative to the market, and as the magnitude of the cost disadvantages at smaller scales increases.

Numerous factors can contribute to these scale-economy barriers. Sometimes the most efficient of production methods, in terms of per unit costs, require large capacities. Moreover, costs often decline as experience increases, be that a function of learning effects, product redesigning or otherwise. Such an environment may create obstacles to entry. However, given the correct setting, these apparent economic barriers may be overcome, or may even benefit the newcomer. For instance, an entrant might purchase or build the newest and largest facility available in the market, while long-term contracts might restrict incumbents to the use of out-moded methods of production. The entrant could especially challenge existing firms and earn immediate profits in markets experiencing increasing demand.[27]

B. *Artificial Barriers*

Artificial (as opposed to natural) barriers result from actions by others, whether inadvertent or purposeful.[28] A typical example is where state or federal regulators impose delays and costs for entry beyond those experienced by existing competitors.[29]

Existing competitors may also possess the ability to strategically erect artificial barriers. These barriers may or may not

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27. Miller, *supra* note 2, at 584. In many respects this hypothetical reflects the dynamics of most markets, where scale economies and technology frequently change with competitive endeavors. Under the Merger Guidelines, set forth by the Department of Justice, entry is said to be "generally facilitated by the growth of the market and hindered by its stagnation or decline." 4 Trade Reg. Rep. (CCH) ¶ 13,103, at 20,562 n.21 (June 14, 1984). *See also* McCaw Personal Communications, Inc. v. Pacific Telesis Group, 645 F.Supp. 1166, 1173 (N.D. Cal. 1986).

28. BARRIERS, *supra* note 5, at 21.

29. *See* Southern Pac. Communications Co. v. American Tel. & Tel. Co., 740 F.2d 980, 1001 (D.C. Cir. 1984) (the "costs and delays of the regulatory process clearly constitute barriers to entry"), *cert. denied*, 470 U.S. 1005 (1985); United States v. Rockford Memorial Corp., 1989-1 Trade Cas. (CCH) ¶ 68,462, at 60,541 (N.D. Ill. 1989).

result from actions directly focused on any single newcomer. Product differentiation is one such type of obstacle. Successful firms generally establish name recognition with the public, reflecting desirable traits for the product or service. This accumulated goodwill is frequently maintained through sales promotion. To overcome buyer preferences, new companies then must do more than develop a satisfactory product or service.[30] They must convince people to know, test and prefer their offering.[31] If companies undertake this sales effort only by charging lower prices for equivalent offerings, they may be less profitable. On the other hand, if companies invest heavily in remedial advertising to generate recognition, they may increase the expense in selling the average unit. The resulting high levels of advertising-to-sales ratios create a source of real entry barriers.[32] Any prospective entrant therefore cannot ignore necessary promotional expenses, the uncertainties in overcoming purchasing preferences, and the period over which it hopes to recover its investment.[33]

On the other hand, the entrant is not always disadvantaged. Indeed, every industry participant must bear the many costs in obtaining buyer preferences. Furthermore, a market marked by product differentiation may really invite new offerings as part of customer perceptions of individualized products or services. The willingness of consumers to try new products, especially in an industry where technological innovation is likely, may actually

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30. Costs or control of product designs might also serve as an impediment in this area since such factors similarly manifest the differentiation that might be needed in the face of otherwise unfavorable demand conditions.

31. Graphic Prod. Distrib., Inc. v. Itek Corp., 717 F.2d 1560, 1570 (11th Cir. 1983) (product differentiation is a "major criterion of market power"); *Vertical Restrictions Limiting Intrabrand Competition*, 1977 A.B.A. SEC. ANTITRUST L. 64 ("To the extent that product differentiation has been created, a company will have additional freedom to raise the price of its product above that of competing brands while still retaining a substantial portion of its business.")

32. Federal Trade Comm'n v. Tenneco, Inc., 433 F. Supp. 105, 111 (D.D.C. 1977); Redwood Theatres, Inc. v. Festival Enters., 200 Cal. App. 3d 687, 705-07, 248 Cal. Rptr. 189, 200-01 & n.7 (Cal. Ct. App. 1988) (product differentiation can indirectly lead "to a finding of market power by contracting the size of the relevant market," can result in "relative inelasticity of cross-product demand" and "facilitate the creation of barriers to entry"); R. CAVES, *supra* note 20, at 27-28.

33. *See* U.S. Philips Corp. v. Windmere Corp., 861 F.2d 695, 703 (Fed. Cir. 1988), *cert. denied*, 109 S. Ct. 2070 (1989)(entry barriers are high if large advertising expenditures are required to obtain a foothold and to meet the need for possessing a well-known brand). Exacerbating the potential problem can be the existence of a large incumbent taking advantage of volume discounts offered by the media. *See* Federal Trade Comm'n v. Proctor & Gamble Co., 386 U.S. 568, 579 (1967).

invite entry. In effect, the answer might be to create a new market or submarket.

IV. The Type of Entrant and Entry Mode

In addition to identifying sources of entry barriers, the courts in antitrust litigation should identify what type of company is attempting to enter the market. Moreover, the courts should determine what strategies the company employs in its entry attempts, as well as how competitors respond to those strategies.

Potential competitors come in many forms. They include single entrepreneurs or large, diversified companies. They could move into related endeavors, or enter completely new businesses through a well-financed parent able to provide for entrance on a large scale and subsidize early financial losses.[34] The new competitor might be the third and largest in a year, or the first and only entrant likely over an extensive period of time. In short, courts should identify the number and type of potential competitors.

The heterogeneity in the nature of entry candidates extends beyond the structure and size of those businesses. Management skills and corporate strategies also vary. These factors demand evaluation in order to gauge the impact of entry barriers and the newcomers' likely effect on competitive conditions.[35]

Corporate motives also vary.[36] Leadership might strive for profit maximization, growth of some type, risk reduction through diversification, their own control of the business, other forms of personal welfare, or defensive ends such as vertical integration to control or reduce dependence on external organizations when functioning in another market. The intensity of these motives, like the goals themselves, will probably change over time.

These contrasting intentions speak loudly about whether meaningful barriers are present and whether competitive influ-

34. MCI Communications Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, 1181-82 (7th Cir.) (Wood, J., concurring in part and dissenting in part), *cert. denied*, 464 U.S. 891 (1983). Subsidization by related companies or other products can still mean at least short-term losses, particularly allowing for opportunity costs. Northeastern Tel. Co. v. American Tel. & Tel. Co., 651 F.2d 76, 89 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982).

35. G. Yip, *supra* note 5, at 28-32.

36. Barriers, *supra* note 5, at 4-8.

ences will change. One company could plan to quietly establish a limited presence in the beginning so as to later attack the market more fully with the added experience of management. Another entrant may employ a competitive strategy unique to the market, such as a different product configuration, technological means or distribution approach. These two tactics permit avoidance or postponement of direct confrontation with other firms in the industry.

The form or type of entry is similarly diverse, and thus requires individualized analysis. It is common to think of entrance as the creation of a new firm, but there are endless forms of entry.[37] A new competitor can surface in the form of expansion into new markets by an existing firm. The company may possess established distribution networks, skilled management, access to sources of raw materials, or other resources to partly or wholly overcome some barriers. A company might join the market by initiating business itself, or by associating with an established firm through acquisition, joint venturing or some other type of amalgamation.[38] Alternatively, the "entrant" might be an entity within the same market that is greatly expanding capacity and efforts, or branching into additional product lines.

In addition to variations in the form of entry and types of entrant, the dynamic nature of markets makes them susceptible to significant changes even without new entries. Market shifts also include mobility within strategic groups of competitors.[39] Firms move in and out of markets, but also transfer from one collection of sellers to another within the same market. For instance, a small shop producing a specialty item may leave the set of such fringe companies to directly challenge the few firms that operate on a large scale and offer a full range of such goods to many customers.

The consequences of such flows within markets are many. The various positions of companies within the market means

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37. Federal Trade Comm'n v. Occidental Petroleum Corp., 1986-1 Trade Cas. (CCH) ¶ 67,071, at 62,518 (entry "can be accomplished through expansion or modification of existing capacity, reopening of idle facilities or increasing of imports").

38. Acquisition entry provides the benefit of an immediate and established position, but the acquiring company is not thereby necessarily well suited to compete. A change in ownership of an existing competitor may not add a new competitor in any meaningful sense. On the other hand, an acquiring firm may have far more aggressive plans, greater resources, and engage in the competitive game in a very different fashion. G. YIP, *supra* note 5, at 8.

39. Caves & Porter, *supra* note 16, at 249-57; G. YIP, *supra* note 5, at 26-27.

that entry barriers do not protect all incumbents to the same extent. Different types and degrees of barriers appear among different groups. Low barriers or successful entry at one segment of the market may suggest nothing about competitive influence in other segments or in the market as a whole. When analyzing entry barriers, courts should broaden their policy considerations to include the idea that all incumbents are not the same.

V. Market Entrance

As implied above, the nature of the market affects the likelihood of entrance. More significantly, the characteristics of the market can influence the probable effect of the addition of any newcomer.

The particulars of any market constantly change. Short-term factors contributing to aberrant conditions in a market may impact the timing of an entrant. A favorable market might be one marked by high utilization of capacity, recent technological change, rapid growth in the industry, and great levels of new product activity.[40] The market is a negative arena for entry if the dominant sellers have captive audiences through long-term supply contracts with numerous customers. These types of fluctuating market conditions certainly bear on the chances of entry.

But the success of any entrance is typically driven more by the nature of the market after entry. Entry causes changes in the established firms and customarily the market itself. For example, the new entrant might not exacerbate overcapacity, but rather rid the market of less attractive and efficient participants.[41]

Occasionally the newcomer provides a product offering that is sufficiently different to create an entirely new market. The competitive interactions within the original market would not directly include the new firm over the long run, but its offerings may alter the overall market to a great extent. The newcomer more likely becomes an added player in the same market. With another candidate sharing industry revenues, the market is potentially less profitable for everyone. As such, it is only logical

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40. G. Yip, *supra* note 5, at 39. On the other hand, excess capacity for existing companies could, in various circumstances, represent a discouragement to entry. United States v. Rockford Memorial Corp., 1989-1 Trade Cas. (CCH) ¶ 68,462, at 60,541; Caves & Porter, *supra* note 16, at 245; *Cf.* Landes & Posner, *supra* note 13, at 949 n.26.

41. United States v. Syufy Enters., 712 F. Supp. 1386, 1396 (N.D. Cal. 1989).

and expected that incumbents react and modify the market accordingly.[42]

Threatened or actual reactions by established firms are based upon the information available to those businesses, their assessments of the challenges posed by the new sellers, and perhaps their ability to coordinate retaliatory strategies.[43] A lethargic or unknowing incumbent will not change its practices, while an aggressive firm might purposefully attack the newcomer seeking to take away its profits. It may be difficult to know if the incumbent would have made business changes even absent the newcomer. Even if a firm's changes are in response to entry, the court must decide whether the reactions of existing firms are proper competitive responses, or "unfair" and anticompetitive acts under antitrust laws.

VI. The Risk of Failure

The likelihood of entry, in the face of estimated barriers, is not measured only by anticipated gross revenues. Even factoring in the chances and degree of success is not enough. Courts must also consider the probable losses upon failure.

How easily can a firm exit the market if one does not prevail in the competitive struggle? What is the time period for and cost of removal? Such questions affect decisions on risk aversion and risk reduction, and influence what form of entrance a company employs, or whether the company enters the market at all.

Therefore, it is essential to look beyond barriers to entry and include exiting obstacles and expenses.[44] In many respects, a key step is to ascertain the costs that are irretrievable upon removal. These irretrievable costs are also known as sunk costs, meaning those costs that cannot be eliminated in the short or

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42. Contestable Markets, *supra* note 6, at 473 ("It is understandable and natural for the incumbent firms in an industry who are fearful of enhanced competitive pressures to seek the erection or toleration of protective umbrellas against entry."); Khemani & Shapiro, *On Entry and Mobility Barriers*, 33 Antitrust Bull. 115, 122 (1988) ("Critical to the entry decision is the expected reaction of incumbents.").

43. *See* United States v. Federal Communications Comm'n, 652 F.2d 72, 101 (D.C. Cir. 1980).

44. *See* United States v. Marine Bancorporation, Inc., 418 U.S. 602, 629 (1974) ("Ease of entry into a market presumes ease of exit."). The Merger Guidelines note that "entry is less likely to occur when [the assets necessary to produce the relevant product] are long-lived and highly specialized to the particular application." 4 Trade Reg. Rep. (CCH) ¶ 13,103, at 20,562 n.21 (June 14, 1984).

intermediate run even by a complete stoppage in production.[45] Enormous costs considering anticipated revenues and the risks or chances of failure might foreclose all possibility of entry. In short, the management of a prospective entrant should consider sunk costs both as to how they compare with sunk costs of incumbents and as part of an overall risk equation.

The concept of contestable markets brings the topics of exiting and sunk costs into greater focus. A market is "perfectly contestable" if "entry is absolutely free, and exit is absolutely costless."[46] The attributes of such a market include no more than normal rates of return for participants, the absence of inefficiencies, and pricing at marginal cost.[47]

This notion of contestability posits frictionless departure from the market with a full opportunity to recover costs incurred with the reversible entry. Because all assets are reusable without loss, risk of entry is not a consideration. "The crucial feature of a contestable market [therefore] is its vulnerability to hit-and-run entry."[48] A potential entrant can go in, gather his gains, and depart without cost if competitive responses are disadvantageous. Contestable markets, like perfect competition, do not frequent the world of reality. They do, however, offer a helpful "target for public policy" to which antitrust courts should subscribe.[49]

Whether potential competition is viable is therefore a product of the extent of barriers to exiting, which includes a study of sunk costs. But the extent of these costs is not always readily identifiable. A court should determine whether the newcomer correctly and reasonably evaluated sunk costs and took steps through the selection of technology or otherwise, to avoid such costs. For instance, decisions as to a lease or purchase of various production requirements may minimize sunk costs.[50] Moreover,

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45. *See* Federal Trade Comm'n v. Illinois Cereal Mills, Inc., 691 F. Supp. 1131, 1145 (N.D. Ill. 1988), *aff'd*, 868 F.2d 901 (7th Cir. 1989); Federal Trade Comm'n v. Owens-Illinois, Inc., 681 F. Supp. 27, 51 (D.D.C. 1988); Baumol & Willig, *supra* note 15, at 406.

46. Baumol, *supra* note 7, at 3 (emphasis removed).

47. Although a perfectly competitive market is necessarily perfectly contestable, the opposite is not true. For example, a perfectly contestable market does not require a large number of competitors, small firms or homogenous products. *Id.* at 4.

48. *Id. See also* CONTESTABLE MARKETS, *supra* note 6, at 6-7.

49. CONTESTABLE MARKETS, *supra* note 6, at 35.

50. *See* Corenco Corp. v. Schiavone & Sons, Inc., 362 F. Supp. 939, 947 (S.D.N.Y. 1973), *modified on other grounds*, 488 F.2d 207 (2d Cir. 1973); United States v. Hammermill Paper Co., 1977-1 Trade Cas. (CCH) ¶ 61,380, at 71,386 (W.D. Pa. 1977). A rental market may not cause an elimination of sunk costs, but only transfer the same to

a rational business executive might aggressively enter the market even with extensive sunk costs, because such a move makes it more difficult for others to dislodge the firm from the market and the firm can lose little by staying.[51] Thus, courts must carefully distinguish costs to the new competitor and costs to consumers. A long-term supply contract may protect outlays from waste, yet harm consumers by erecting even higher barriers for subsequent potential entrants.[52]

Finally, the concern of antitrust courts should focus on the differential in the risks faced by the entrant and incumbents. Even established firms are exposed to failure, meaning courts must recognize heightened threats for the newcomer. Nonetheless, the possible entrant, like its predecessors, primarily evaluates whether the expected gains from success exceed the unrecoverable entry costs experienced with failure.[53]

VII. The "Successful" Entry

For antitrust purposes, the courts should evaluate more than the likely or actual occurrence of entry. In many situations courts conclude little from prior entry statistics. Courts must proceed further to assess the potential strength or success of an entry.[54] Stated differently, the fact of entry may not evidence whether market power could erode or disappear with the presence of new competitors. Judges must take into account what newcomers are able and likely to accomplish after entry.

Assume that instead of a manufacturer not using the larger resources of its parent to begin selling a full line of products in an adjoining geographic market, an enterprising individual elects to enter that market on a very small scale, specializing in a single item. This new entrant, even if eventually operating profita-

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those owning the rental items. Baumol & Willig, *supra* note 15, at 407 n.2.

51. Baumol & Willig, *supra* note 15, at 419 n.10.

52. *See* Federal Trade Comm'n v. Illinois Cereal Mills, Inc., 691 F. Supp. 1131, 1145 (N.D. Ill. 1988); Baumol & Willig, *supra* note 15, at 419.

53. Baumol & Willig, *supra* note 15, at 418. *See also* Kelco Disposal, Inc. v. Browning-Ferris Indus., Inc., 845 F.2d 404, 408 (2d Cir.), *cert. granted in part*, 109 S.Ct. 527 (1988), *aff'd*, 109 S.Ct. 2909 (1989).

54. *See* Kennecott Copper v. Curtiss-Wright Corp., 449 F. Supp. 951, 965 (S.D.N.Y. 1978), *rev'd*, 584 F.2d 1195 (2d Cir. 1978). Emphasis should be on the ability to enter as a meaningful competitor and not on whether in fact that newcomer succeeded in entering the market. Reazin v. Blue Cross & Blue Shield, Inc., 663 F. Supp. 1360, 1417, 1435-1437 (D. Kan. 1987).

bly as a boutique business, may never threaten oligopolists or change competition in the industry.[55]

It is therefore insufficient to stop any inquiry with a determination of the number of likely or actual entrants in a market. Whether two or thirty-two new companies appear in the market may demonstrate nothing about the ability of an established firm to limit output. Neither physical ability to join a market nor actual presence within a market tells much of a story.[56] In addition, the financial performances of these newcomers do not demonstrate their power to effectuate price reductions in the industry.

How is "success" then identified and measured?[57] Of course, a few situations indicate actual breakdowns in monopoly or market power. Effective price cutting by a new seller may lead to competitive success on every front. In different cases, a potential competitor may provide a very real check on the prices of established firms. The effect of this check may equal or exceed the impact of actual competition by that new seller upon entry. In other situations, the judiciary might return to the familiar proxy of market shares.[58]

A study of changing market shares may reveal the consequences of entry.[59] A large market presence by a newcomer, resulting from a transfer of market shares from industry leaders,

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55. *Reazin*, 663 F. Supp. at 1417 ("the only effective challenge . . . comes from alternative delay systems," not from other smaller, conventional companies). Viewed differently, barriers to entry can normally be expected to be enhanced when a firm seeks to penetrate the core of an oligopoly.

56. Leddy, *Entry Issues in Merger Analysis*, 54 ANTITRUST L.J. 1257, 1258-60 (1986).

57. Growth, or emergence, can come in many ways. The firm itself can increase in size with more employees, net assets, or physical capacity. Another measurement is of the domain of the firm, through enhancements in the number of customers, sales, or market shares. BARRIERS, *supra* note 5, at 1-2.

58. *See, e.g.*, Johnson v. Blue Cross/Blue Shield, 677 F. Supp. 1112, 1120 (D.N.M. 1987) ("inability of entering companies to capture any significant portion of the market" could suggest defendant possessed market power). Entry theory and research to date seldom cover the success of new competitors. Nevertheless, one study found the average market-share impact of entrants to be surprisingly small. G. YIP, *supra* note 5, at 105-26.

59. The beginning market shares of "entrants" would be zero in the case of newly formed enterprises, but something greater in the case of acquisition entry or expansion by a present rival. In the cases of new companies founded by "insiders" of an incumbent that are taking former accounts, some adjustment might also be required to reflect the true extent or limit of its impact. *See* Oahu Gas Serv. v. Pacific Resources, Inc., 838 F.2d 360, 366-67 (9th Cir.) *cert. denied*, 109 S. Ct. 180 (1988). Obviously the net change is the appropriate measure. Moreover, this yardstick may need adjustment in some instances to account for the extent of any offset caused by no longer being a potential competitor.

may reflect the nature of a market and events bearing on market power. Thus, gains in market share could often arise from the managerial skills and strategies of potential entrants, the competitive characteristics of those firms, the overall structure of the market, the responding tactics of incumbents, and the reactions of customers, suppliers and distributors.

Changes in market shares are, however, misleading in some circumstances. For example, the share obtained by a newcomer may simply tend to mirror the market presence of a comparable firm before the latter's recent exit from the market. Market shares of entrants might measure increases in demand or supply factors without any real ability to cause price declines. A not insignificant market share promptly obtained by an entrant may merely reflect a cooperative firm joining an oligopoly; this type of entry is not indicative of a normal successful entry and might create entry barriers for subsequent entry attempts by aggressive candidates.

Whether courts rely on market-share changes or otherwise, ascertaining "successful" entry is very difficult and yet imperative. Unlike the one-time event of entry and mode of appearance, the degree of "success" is neither instantaneous nor isolated. Instead, success is ever changing and influenced by the ongoing and evolving struggle between entrants and incumbents. However, analysis of this competitive interplay is more helpful in sorting out market power than mere noting that an entrant previously appeared in the market.[60]

VIII. Time For Successful Entry

"For antitrust purposes, the *time* it takes to enter effectively is at least as important as the *fact* that entry can occur."[61] Entry, and any success with the venture, do not happen instantly. A successful market entry, presence and impact requires a good deal of time. In such situations the anticompetitive consequences are not immediately removed and injury might occur during the interim. The strength of entry barriers is, in part, a product of the delays in overcoming the same.[62] Delays in both

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60. The eventual position of the entrant may differ from its original goal. This may be true because of errors in its early assessments, changes in objectives, or inability to satisfy its desires as the competitive process unfolds and runs its course over time.

61. Rule, *Merger Enforcement Policy: Protecting the Consumer*, 56 Antitrust L.J. 739, 744 (1987) (emphasis added).

62. *See, e.g.*, Ball Memorial Hosp., Inc. v. Mutual Hosp. Ins., Inc., 784 F.2d 1325,

making an appearance and meaningfully establishing a competitive position raise serious questions about whether the antitrust laws should be stayed to await the invisible hand of the marketplace to correct for an anticompetitive posture.[63]

Many factors contribute to an extensive delay between the date of first consideration of entry and the time when the newcomer is an actual market competitor. Slowness in design processes, or the importance of brand recognition, represent a few such causes. Reputations are not made in one day.

With delays, incumbents have more time to respond to or preempt new ventures.[64] Alternatively, incumbents can afford to wait longer to reduce their prices to a competitive level.[65] For the entrant, lengthy periods of entry translate into higher sunk costs because initial losses must be absorbed in anticipation of later success. In short, an antitrust court should assess whether or not delays result from legitimate competitive factors, as well as determine whether an entrant has taken appropriate measures in attempting to overcome these delays.

IX. Actual Experience

Whether firms can enter a market and be effective thereafter calls for predictions based on more than the theories of economists and attorneys.[66] Courts must consider the differing characteristics of the actual and potential participants, particularly

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1335 (7th Cir. 1986); United States v. Federal Communications Comm'n, 652 F.2d 72, 100 (D.C. Cir. 1980); Federal Trade Comm'n v. Owens-Illinois, Inc., 681 F. Supp. 27, 51 (D.D.C. 1988). It has been said that "[m]arket definition deals with rapid entry . . . while ease of entry generally refers to entry over a longer period of time." Federal Trade Comm'n v. Occidental Petroleum Corp., 1986-1 Trade Cas. (CCH) ¶ 67,071, at 62,513. *See also* United States v. Waste Management, Inc., 743 F.2d 976, 979 (2d Cir. 1984); Associated Radio Serv. Co. v. Page Airways, Inc., 624 F.2d 1342, 1349 n.11 (5th Cir. 1980), *cert. denied*, 450 U.S. 1030 (1981); Drs. Steuer & Latham v. National Medical Enters., 672 F. Supp. 1489, 1511 (D.S.C. 1987), *aff'd unpublished disposition*, 846 F.2d 70 (4th Cir. 1988).

63. R. Bork, *supra* note 1, at 311. The Merger Guidelines state that if entry will not occur within two years it cannot be relied upon as a means of eliminating an anticompetitive state. 4 Trade Reg. Rep. (CCH) ¶ 13,103, at 20,562 (June 14, 1984).

64. *See* Federal Communications Comm'n, 652 F.2d at 102.

65. Salop, *supra* note 2, at 558.

66. Rule, *supra* note 61, at 744 ("whether entry is easy must be based on facts, not on an economist's or a lawyer's unsubstantiated theory that entry should be possible"). *See also* Salop, *supra* note 2, at 552 ("Although it is clear that the future course of markets is the issue at stake, historical evidence might be considered more credible than theoretical constructs in predicting the future, unless it is obvious why the past would not be a good predictor").

as to their goals and strategies. Evaluating firms requires more than looking at whether they could conceivably enter a marketplace, or even whether they conclusively state a vague ambition to do so in the future. Actual studies or plans by management are more helpful than any subjective or speculative evidence.[67]

Occasionally, the track record of past entry attempts by others shape the prognostications of a firm's ability to enter.[68] Have other companies previously tried to come into the market, and if so, where are they now? Such histories are probative and are most helpful if the reasons for prior successes and failures are carefully reviewed.

A past marked by numerous entries possibly indicates low entry barriers.[69] However, it is also possible that market conditions differing from those of today allowed such entries. In fact, new potential competitors may observe greater obstacles made in part by the recent entrants themselves. In addition, poor performance by a cartel which subsequently learns to control the market may explain earlier successes.[70]

Obviously, industries lacking previous entry experience could possess high barriers.[71] Courts must however inquire

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67. *See, e.g.*, Federal Trade Comm'n v. Atlantic Richfield Co., 549 F.2d 289, 296-97 (4th Cir. 1977); Corenco Corp. v. Schiavone & Sons, Inc., 362 F. Supp. 939, 945-46 (S.D.N.Y.), *aff'd*, 488 F.2d 207 (2d Cir. 1973). Nonetheless, only in a small percentage of cases might entry decisions actually be based upon detailed and extensive market studies.

68. Rule, *supra* note 61, at 745 (the U.S. Department of Justice will investigate previous attempts to join the relevant market). Facts on prior retaliations by established firms can also be material as a predictor.

69. California v. American Stores Co., 697 F. Supp. 1125, 1131 (C.D. Cal. 1988) (citing United States v. Hughes Tool Co., 415 F. Supp. 637 (C.D. Cal. 1976)), *aff'd in part and rev'd in part*, 872 F.2d 837 (9th Cir. 1989); United States v. Hammermill Paper Co., 1977-1 Trade Cas. (CCH) ¶ 61,380, at 71,386 (W.D. Pa. 1977). This assumes entry that was potentially meaningful. Oahu Gas Serv. v. Pacific Resources, Inc., 838 F.2d 360, 367 (9th Cir. 1988) ("The second entrant . . . did win some accounts, but the evidence that the firm remained very small could reasonably preclude a decision that . . . entry reflected a breakdown of barriers to entry."). Along these lines, the judicial focus has been upon opportunity for significant competitive effect overall and not the later success or failure of any *single* competitor. United States v. Aluminum Co. of Am., 214 F. Supp. 501, 513 (N.D.N.Y. 1963) (subsequent withdrawal by certain newcomers was only occasioned by an inability to make a profit), *rev'd* 377 U.S. 271 (1964).

70. Ordover & Wall, *supra* note 3, at 13 ("in evaluating a history of entry, it is therefore important to consider the possibility that poor market performance, rather than low barriers, is at work.").

71. *See, e.g.*, Kelco Disposal, Inc. v. Browning-Ferris Indus., Inc., 845 F.2d 404, 408 (2d Cir. 1988) ("only two companies entered the relevant market during the eleven-year period"), *cert. granted in part*, 109 S. Ct. 527 (1988); *aff'd*, 109 S. Ct. 2909 (1989); Fiberglass Insulators, Inc. v. Dupuy, 1986-2 Trade Cas. (CCH) ¶ 67,316, at 61,632 (D.S.C.

whether a lack of new entities occurred only from near optimal competitive conditions leaving little for possible gain.[72]

X. Predatory Versus Innocent Erection of Barriers

Given some awareness of the variations in the cause, nature and effect of entry barriers, the question remains whether the makers of antitrust policy should formulate standards premised upon this topic. Is there a proper concern for the strategic erection of barriers to block or reduce competition? Apart from predation, should courts consider entry barriers as a factor in assessing exclusionary or restrictive practices?

Courts exhibit a distaste for high entry barriers. Courts often construe entrance difficulties as evidence of a dangerous probability that incumbents will successfully attain a monopoly, even in situations where the defendants hold a limited share of the relevant market.[73] At the same time, however, entry barriers are only one of many factors accepted by the courts in demonstration of attempted monopolization.[74]

A. *Non-Predatory Barriers*

Lack of predation or intention to create entry obstacles should not extinguish the antitrust concern. Even if not built by the defendants, high entry barriers should provide a backdrop for adjudging allegedly restrictive conduct. As noted in *Southern Pacific Communications Co. v. American Telephone & Telegraph Co.*:

> The District Court also erred in ruling that costs and delays imposed by the regulatory process are not barriers to entry. The District Court based this ruling on the ground that the regulatory agencies, and not AT&T, are responsible for

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1986) ("there have been no new entrants . . . for five years").

72. Crounse Corp. v. Interstate Commerce Comm'n, 781 F.2d 1176, 1190 (6th Cir.), *cert. denied*, 479 U.S. 890 1986); Federal Trade Comm'n v. Occidental Petroleum Corp., 1986-1 Trade Cas. (CCH) ¶ 67,071, at 62,518 (D.D.C. 1986); United States v. Waste Management, Inc., 743 F.2d 976, 983 (2d Cir. 1984).

73. Kellam Energy, Inc. v. Duncan, 668 F. Supp. 861, 891-92 (D. Del. 1987). *See also* Associated Radio Serv. Co., v. Page Airways, Inc., 624 F.2d 1342, 1357 (5th Cir. 1980), *cert. denied*, 450 U.S. 1030 (1981).

74. Other indicators include intent, elasticity of consumer demand, the nature of the anticompetitive conduct, market share, the strength of the competition, and probable development of the industry. International Distribution Centers, Inc. v. Walsh Trucking Co., 812 F.2d 786, 792-93 (2d Cir.), *cert. denied*, 482 U.S. 915 1987), *noted in* Kelco Disposal, 845 F.2d at 408-09.

> these costs and delays. The defendant's innocence or blameworthiness, however, has absolutely nothing to do with whether a condition constitutes a barrier to entry. Any market condition that makes entry more costly or time-consuming and thus reduces the effectiveness of potential competition as a constraint on the pricing behavior of the dominant firm should be considered a barrier to entry, regardless of who is responsible for the existence of that condition.[75]

The courts rigorously scrutinize monopolizing conduct because of the possibility for significant anticompetitive harm when the actor possesses actual or apparent market clout. Whether the defendant established barriers resulting in market power should not affect the standard for adjudging the exclusionary conduct in question.[76] The undesirable consequences are the same in either instance. It is not enough to simply ask whether the defendant was an innocent bystander to the development of entry barriers. Ironically, in markets with large barriers, the probability of "predatory" conduct is minimal because such practice is unneeded.[77]

B. Predatory Barriers

Courts have good reason to condemn efforts intended to mount entry barriers.[78] Antitrust law does not sympathize with the claim that market forces will eventually overcome even the most egregious cartels, and therefore rejects strategic development of obstacles to entry.[79] Moreover, steps to block new competition are perhaps the most likely and effective means to pro-

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75. 740 F.2d 980, 1001 (D.C. Cir. 1984).

76. *Cf.* Instructional Sys. Dev. Corp. v. Aetna Casualty & Sur. Co., 817 F.2d 639, 649 (10th Cir. 1987) ("Although a monopolization claim requires a showing of monopoly power, the acts complained of need not involve the use of that power if they contribute to its acquisition or maintenance."); Consolidated Gas Co. v. City Gas Co., 880 F.2d 297, 301 (11th Cir. 1989).

77. CONTESTABLE MARKETS, *supra* note 6, at 482 n.9 (quoting R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 87 (1976)).

78. CONTESTABLE MARKETS, *supra* note 6, at 477 n.6 ("there are legitimate roles for antitrust activities and regulation in markets in which there are substantial departures from contestability and in which contestability cannot readily be stimulated").

79. Rule, *supra* note 61, at 745 ("given enough time, market forces will overcome even the strongest cartel," but "[o]n the other hand, the costs to the world's economy [could be] enormous during the time it [takes] to erode [the] power."); CONTESTABLE MARKETS, *supra* note 6, at 477 ("in fields where technological conditions and other unavoidable circumstances impose heavy sunk costs and other obstacles to exit and entry, markets will not be contestable and the market mechanism cannot always be trusted to produce benign results.").

tect market position. The United States Supreme Court recognized as much: "Prevention of all potential competition is the natural program for maintaining a monopoly here, rather than any program of actual exclusion. 'Prevention' is cheaper and more effective than any amount of 'cure.' "[80]

The difficulty is in identifying those barriers that are inappropriately developed or heightened. Some "barricades" are a natural result of competition, and must not be disturbed by the courts. For example, customer preference for certain services, even at higher prices, is not worthy of attack when emanating from goodwill or a proven track record.[81] Similarly, courts should cautiously review barriers generated by efficiencies or resulting from legitimate business objectives. But what are the "efficiencies"? Does this merely mean practices are excused because they are productive for a single company, especially taking into account that the correct antitrust focus is upon competition as a whole and not any one competitor?[82] In some circumstances consumers are aided by rules of law promoting the entry of firms which are initially less efficient. Such rules combat a monopolist with no incentive to pass along cost savings.[83]

The following examples illustrate the difference between deterring actions purposely used to slow entry and barriers unintentionally erected as a side effect of innocent profit maximization. Each situation also evaluates the policy of affirmatively promoting reductions in entry barriers. As an initial matter, it is instructive to recall that barriers which elevate sunk costs for entrants are particularly troublesome deterrents.

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80. American Tobacco Co. v. United States, 328 U.S. 781, 797 (1946). *See also* Redwood Theatres, Inc. v. Festival Enters., Inc., 200 Cal. App. 3d 687, 708, 248 Cal. Rptr. 189, 202 (Cal. Ct. App. 1988) ("both the legislative history and subsequent interpretation of the Sherman Act reveal that it was intended to prohibit unreasonable restraints on the freedom of entrepreneurs to enter new markets or to expand a small market share.").

81. United States v. Waste Management, Inc., 743 F.2d 976, 984 (2d Cir. 1984).

82. *See, e.g.*, United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 370 (1963); RSR Corp. v. Federal Trade Comm'n, 602 F.2d 1317, 1325 (9th Cir. 1979) (argument that "merger can be justified because it allows greater efficiency of operation" has been "rejected repeatedly"), *cert. denied*, 445 U.S. 927 (1980); California v. American Stores Co., 697 F. Supp. 1125, 1133 (C.D. Cal. 1988) (rejecting an efficiency defense and stating that the court was "not convinced that defendants will invariably pass these savings on to consumers").

83. *See* MCI Communications Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, 1180-81 & n.15 (7th Cir. 1983) (competition from entry in such situations "might generate even more efficiencies and consumer benefits," especially if the added production costs for the newcomer represent only a short-run phenomenon).

1. *Limit pricing*

Courts and commentators regularly denounce the practice of limit pricing.[84] Limit pricing is the charging of rates low enough to discourage entry, but sufficient to provide economic profit to the practitioner. The notion is that one with market power sacrifices some monopoly profits to price down to a level just lower than the average production costs of a new entrant, thereby dissuading actual entry for fear of negative returns. By definition, however, little can be said in defense of this practice.[85] The threat or actual use of such preemptive acts translates into the blocking of new competition.[86]

The antitrust chore is to cull out the pricing activity which truly qualifies as limit pricing. Price reductions may be without devious intent; such reductions result in the procompetitive consequence of lower charges to consumers. Price cuts may also reflect an effort to meet competitive moves by others, and may occur where entry barriers are relatively slight.[87] The chosen level of price decline may merely exclude the most inefficient of newcomers.[88] In short, both motive and competitive effect appear elusive.

The task of identifying limit pricing is complicated by the nature of many markets. With product differentiation and multiple sellers, a newcomer may find it difficult to identify a meaningful price cut.[89] This is especially true if an incumbent's intermediate strategy is to cut the prices of some but not all products

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84. *See, e.g.*, Phototron Corp. v. Eastman Kodak Co., 842 F.2d 95, 101 (5th Cir. 1988), *cert. denied*, 108 S.Ct. 1996 (1988); Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 729 F.2d 1050, 1061-62 (6th Cir. 1984) (Wilhoit, J., dissenting), *cert. denied*, 469 U.S. 1036 (1984); *MCI Communications*, 708 F.2d at 1181; Dimmitt Agri. Indus., Inc. v. CPC Int'l, Inc., 679 F.2d 516 (5th Cir. 1982), *cert. denied*, 460 U.S. 1082 (1983); BARRIERS, *supra* note 5, at 86 ("The literature on the subject is vast and complex, but the general conclusion is that the use of limit pricing to deter entry can impede the growth of small firms.").

85. Possession of excess capacity may render a threat of limit pricing more credible.

86. This is not to say that it is always economically sensible for businesses to engage in limit pricing. The immediate capture of available monopoly profits might produce better financial gains. Arizona v. Maricopa County Medical Soc'y, 643 F.2d 553, 558 (9th Cir. 1980), *rev'd.*, 457 U.S. 332 (1982).

87. *See Transamerica Computer*, 698 F.2d at 1389 n.19; Areeda & Turner, *Williamson on Predatory Pricing*, 87 YALE L.J. 1337, 1344 n.25 (1978) (quoting F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 224-25 (1980)).

88. *See* Hanson v. Shell Oil, 541 F.2d 1352, 1358 n.5 (9th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977); Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697, 706-07 (1975).

89. *See* Caves & Porter, *supra* note 16, at 243.

to a level that slightly exceeds the newcomer's costs.[90] As to the antitrust concern of using limit pricing to later reap ill-gotten gains, that subsequent market may not be a candidate for such profiteering if marked by high elasticity of demand, great technological changes or uncertain cost conditions.[91]

2. *Excessive advertising*

Promotional efforts are often among the more productive aspects of market rivalry. However, "[a]dvertising that creates barriers to entry" constitutes "predatory behavior of the type the antitrust laws are designed to prevent."[92] In *American Tobacco Co. v. United States*, the Supreme Court expressed its concern about massive advertising:

> Such advertising may benefit indirectly the entire industry, including the competitors of the advertisers. Such tremendous advertising, however, is also a widely published warning that these companies possess and know how to use a powerful offensive and defensive weapon against new competition. New competition dare not enter such a field, unless it be well supported by comparable national advertising.[93]

As with limit pricing, it is difficult to ascertain when an otherwise normally competitive act goes too far. Errors in deciding whether advertising is improperly excessive creates confusion in the economy and retards competitive activity. Nonetheless, courts cannot ignore or bless extensive promotion in all instances.

A judge will seldom have conclusive evidence of a dominant competitor using its massive resources for product promotion with the sole purpose of damaging a new entrant.[94] Rather, the

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90. F. SCHERER, *supra* note 10, at 224.

91. *See* Northeastern Tel. Co. v. American Tel. & Tel. Co., 651 F.2d 76, 89 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982); Cargill, Inc. v. Monfort, Inc., 479 U.S. 104, 119 n.15 (1986); Areeda & Turner, *supra* note 87, at 1344.

92. Phototron Corp. v. Eastman Kodak Co., 842 F.2d 95, 100 (5th Cir.), *cert. denied*, 108 S. Ct. 1996 (1988). *See also* Southern Pacific Communications v. American Tel. & Tel. Co., 740 F.2d 980, 1002 (D.C. Cir. 1984), *cert denied*, 470 U.S. 1005 (1985); *Northeastern Telephone*, 651 F.2d at 93; Berkey Photo v. Eastman Kodak Co., 603 F.2d 263, 287 (2d Cir. 1979) (publicizing of product forbidden when the extent thereof is "so unwarranted by competitive exigencies as to constitute an entry barrier"), *cert. denied*, 444 U.S. 1093 (1980).

93. 328 U.S. 781, 797 (1946).

94. *See* MCI Communications Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, 1183 (7th Cir. 1983).

courts generally sift through facts to determine whether advertising reached beyond reasonable steps to advance product differentiation and instead generated unnecessary obstacles for new competitors.[95]

Courts should consider whether excessive advertising causes extremely large and discriminatory sunk costs for the new competitor.[96] Initial promotion is a necessary, yet risky, use of funds. Without a large customer base at the beginning, volume discounts on advertising might not be sensible. Unsuccessful brand recognition requires enormous fixed costs, and does not provide for recovery of assets in the case of failure.[97]

3. *Vertical integration*

Vertical integration involves control within a single enterprise of multiple stages in the production and distribution of an end product. It occurs in many ways.[98] Integration might be partial, as with upstream contracts that reach backward into the production process to control access to essential raw materials. Alternatively, a firm may engage in a downstream merger to acquire dealers forward in the distribution line.

Quite correctly, the courts never treat vertical integration as *per se* unlawful under the antitrust laws.[99] Indeed, vertical integration can produce procompetitive consequences. The primary benefits are typically twofold. First, savings in market transaction costs might be passed on to consumers. Second, new interrelationships could result in technological economies.[100] On the

95. *See* Will v. Comprehensive Accounting Corp., 776 F.2d 665, 673 n.4 (7th Cir. 1985), *cert denied*, 475 U.S. 1129 (1986); Purex Corp. v. Proctor & Gamble Co., 596 F.2d 881, 888 (9th Cir. 1979).

96. *Will*, 776 F.2d at 673 n.4; Caves & Porter, *supra* note 16, at 243 & n.3.

97. On the other hand, some newcomers may be particularly adept at advertising, and with access thereto, find themselves advantaged against inefficient incumbents.

98. *See, e.g.*, Paschall v. Kansas City Star Co., 727 F.2d 692, 696 n.3 (8th Cir.), *cert. denied*, 469 U.S. 872 (1984); Auburn News Co. v. Providence Journal Co., 659 F.2d 273, 278 (1st Cir. 1981), *cert. denied*, 455 U.S. 921 (1982); Mantell, *Antinomies in Antitrust Law: Tying and Vertical Integration*, 7 J.L. & COM. 23, 28 (1987). *See generally* McGee & Bassett, *Vertical Integration Revisited*, 19 J.L. & ECON. 17 (1976).

99. *Paschall*, 727 F.2d at 698, 704. *See also* United States v. Columbia Steel Co., 334 U.S. 495, 525 (1948) ("vertical integration, as such without more, cannot be held violative of the Sherman Act").

100. *See also* Mantell, *supra* note 98, at 34 n.34; *Auburn News Co.*, 659 F.2d at 278; Byars v. Bluff City News Co., 609 F.2d 843, 861 (6th Cir. 1979) ("In theory, a monopolist will only take over operations" at another level "if it is at least as efficient;" in any case, integration assures no more than prices at the "optimum monopoly level").

other hand, claimed efficiencies may not actually exist in any specific situation, translate through to benefits for consumers, be achieved with acts which are the least restraining, or advance the competitive process.[101] Moreover, the Supreme Court permits the sacrifice of possible economies and lower costs to consumers to satisfy other antitrust goals such as decentralization.[102]

Because of the uncertain consequences of vertical integration, judges generally review each case on its own merits and search for any unreasonable antitrust effects.[103] The courts expressly construe vertical integration which increases first-level entry barriers as having sufficiently adverse impact so as to warrant condemnation.[104] In short, the problem amounts to identifying and quantifying integration that unlawfully raises obstacles to entry.[105]

In some cases, the courts confront evidence of vertical activity used primarily to destroy a competitor and discourage further entry. Antitrust laws normally condemn such motives aimed at suppressing competition.[106] Predatory goals speak loudly and tend to outweigh any theoretical or abstract estimates by economists. While intentions alone do not constitute antitrust infractions, they frequently provide the best barometers for anticipating adverse economic consequences. However, clear instances of evil motives are rare and elusive. Consequently, the legal inquiry into whether vertical integration im-

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101. *Paschall*, 727 F.2d at 703; Krattenmaker & Salop, *Anticompetitive Exclusion: Raising Rivals' Costs To Achieve Power Over Price*, 96 YALE L. J. 209, 277-82 (1986).

102. Brown Shoe v. United States, 370 U.S. 294, 344 (1962); Federal Trade Comm'n v. Proctor & Gamble Co., 386 U.S. 568, 580 (1967).

103. *Paschall*, 727 F.2d at 704. *See also* Becker v. Egypt News, 713 F.2d 363, 366 (8th Cir. 1983).

104. *See* United States v. Loew's, Inc., 705 F. Supp. 878, 889-90 (S.D.N.Y. 1988); Syufy Enters. v. American Multicinema, Inc., 793 F.2d 990, 995-96 (9th Cir. 1986); *Paschall*, 727 F.2d at 702; *Becker*, 713 F.2d at 370; *Byars*, 609 F.2d at 861; Poster Exchange, Inc. v. National Screen Serv., 431 F.2d 334, 339 (5th Cir. 1970), *cert. denied*, 401 U.S. 1015 (1971). This area has been a factor in the spawning of the "essential facilities" doctrine. McKenzie v. Mercy Hosp., 854 F.2d 365, 368-69 (10th Cir. 1988). *See also* Fishman v. Estate of Wirtz, 807 F.2d 520, 539-40 (7th Cir. 1986). *Cf.* Fortner Enters., Inc. v. United States Steel, 394 U.S. 495, 509 (1969).

105. *Byars*, 609 F.2d at 861.

106. *See Paschall*, 727 F.2d at 696-98; *Becker*, 713 F.2d at 368; *Byars*, 609 F.2d at 855-56; *Poster Exchange*, 431 F.2d at 339-40. *See generally* Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359 (1927); P. AREEDA, ANTITRUST LAW, ¶ 729.3 (Supp. 1982); Note, *Refusals to Deal by Vertically Integrated Monopolists*, 87 HARV. L. REV. 1720, 1732-39 (1974).

properly elevates entry barriers tends to focus upon three economic factors.[107]

First, courts ascertain whether vertical integration requires potential entrants in the primary market to simultaneously enter a secondary market. In other words, is capacity available or readily generated in the secondary market to accommodate the resource needs of a newcomer wishing to join only the primary market? Given a critical assumption of generally comparable quality and price at adequate volumes[108], other supply sources could leave the new entrant disadvantaged only by not experiencing the efficiencies of integration.[109] Supply access may even come from the integrated firms possessing divisible resources and excess capacity. However, fear of price squeezes and other similar actions by competitors controlling the terms and conditions of use may make this option less than viable. Alternatively, new sources may arise at the secondary level to accommodate primary market entrants. Still, delays and uncertainties in discovering or securing resources at the secondary level may translate into extensive lags in entry at the primary level.

Second, the need for added entry at the secondary level could make any entrance in primary markets less likely, substantially more difficult, or subject to extensive delays. More specifically, anticompetitive conditions exist where contemporaneous entry at two or more levels is incrementally more expensive than entry only at the primary stage. Numerous factors[110] might heighten both the relative costs and risks with entry at more than one distribution stage.[111] Lack of managerial skills, knowledge or incentives could retard serious pursuit of multiple

107. These guidelines generally parallel the approach by the Department of Justice in evaluating vertical acquisitions. 4 Trade Reg. Rep. (CCH) ¶ 13,103, at 20,565-66 (June 14, 1984); *See also* Mantell, *supra* note 98, at 31.

108. After all, the material questions surround opportunities for entry in a meaningful or "successful" fashion. *See infra* text accompanying notes 54-60. The acquiring of supplies from the noncompetitive fringe at supranormal prices may deny such opportunities.

109. Auburn News Co. v. Providence Journal Co., 659 F.2d 273, 278 (1st Cir. 1981), *cert. denied*, 455 U.S. 921 (1982). *See also Ball Memorial Hosp.*, 784 F.2d at 1335; *Paschall*, 727 F.2d at 702; Kellam Energy, Inc. v. Duncan, 668 F. Supp. 861, 891 (D. Del. 1987).

110. United States v. Loew's, Inc., 705 F. Supp. 878, 883-84, 890 (S.D.N.Y. 1988).

111. These costs or risks could be greater than those accompanying entry at solely the primary level, disproportionately more than anticipated returns at any secondary level, or well in excess of those faced by integrated incumbents. As to the latter disparity, efficiencies in any procompetitive sense may or may not be the cause.

entries by possible newcomers. Increased risks with such substantial entry may lead to rigorous capital costs. Assets needed for the secondary market may require so much specialization and longevity as to increase exposure to sunk costs. Minimum efficiencies associated with an integrated presence might mean scale economies of a magnitude to give pause to potential competitors. In short, an otherwise efficient newcomer for a primary market may decide to forgo entry because of the unattractive costs or inability for direct participation in other stages of distribution.

Third, courts look to see whether problems of entry in the primary market negatively affect reasonable competitive performance. Failure of a single entrant to join a primary market, because of lack of skills at the secondary level, may not hamper an already competitive industry occupied by numerous incumbents and open to other entry candidates. On the other hand, a recent acquisition of important sources of supply may allow for one more immediate and minor entry, while at the same time dissuade large potential competitors from a later entrance.

In sum, binding commitments from vertical relationships could prevent equal or more efficient firms from participating in a market.[112] Integration may further thwart innovation and remove an important market mechanism for organizing distribution exchanges. Courts must study and contrast these antitrust concerns with integration efficiencies that reach beyond a sole purveyor to advance the competitive process.

XI. Conclusion

Entry is one of the principal factors affecting the competitive performance of an industry. Newcomers often provide significant challenges to established firms. They frequently bring innovation and new approaches to markets. Potential competition can be the answer to industry concentration which otherwise facilitates anticompetitive consequences.

By centering upon market power, antitrust analysis necessarily gives importance to the element of entry. Indeed, antitrust principles are most sensibly constructed when promoting conditions favorable to easy entry and exit. Conduct obviously foreclosing meaningful access to markets is to be judicially reviewed

112. *See, e.g.*, Carpenters Local Union No. 1846 v. Pratt-Farnsworth, Inc., 690 F.2d 489, 534 (5th Cir. 1982), *cert. denied*, 464 U.S. 932 (1983).

with healthy skepticism, and not accepted merely because it advances the economic state of any single incumbent. Exclusionary actions in a market with high entry barriers are evaluated more rigorously, irrespective of whether the firm created those obstacles.

The appropriate evidentiary search as to entry barriers logically tracks the reasons for promoting ease of entrance and exit. A candidate for entry must be assessed in terms of opportunity for successful impact upon prices and output, not simply a presence within the industry. Possible entrants must be considered with regard to strategies and talents rather than leaving the judicial examination to hypotheticals or economic theory. Entry is properly evaluated according to its likelihood of influencing markets in the near term, so that antitrust enforcement is not always stayed in favor of the invisible hand of the marketplace. Study must be undertaken of the nature of discriminatory risks of failure facing the new competitor, as well as the appropriateness of responses by incumbents. Although such levels of scrutiny involve extensive judicial resources, only with that attention can antitrust courts hope to enhance competitiveness.