ARTICLES

RETHINKING THE POTENTIAL COMPETITION DOCTRINE

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INTRODUCTION

The rapid development of technology-based industries and the continued trend toward deregulation in traditionally regulated industries, such as airlines, energy, and telecommunications, pose significant challenges to successful antitrust enforcement.[1] A critical antitrust issue in these markets is whether firms who are spectators to this dynamic competition have an impact in the marketplace. Their impact could be either ongoing or prospective. The spectator firm could one day enter the marketplace with more efficient or innovative products, enhancing competition. Or, the firm's presence as a spectator could, by itself, motivate the incumbents in the marketplace to compete and innovate more than without the firm.

Economic analysis of the spectator firm's role in the competitive process generally bears out its significance. The economic theory of contestable markets, for example, shows that nonincumbent firms constrain the pricing behavior of incumbents.[2] Clearly, mergers, contractual arrangements or other market conduct that affect these types of spectator firms could endanger the vitality of the marketplace.

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1. This technological change may have driven the largest period of sustained economic growth in the history of the United States. Indeed, Joseph Schumpeter's theory of creative destruction draws a connection between economic growth and technological change. *See* JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 81-86 (5th ed. 1976); *see also* Robert P. Merges, *Commercial Success and Patent Standards: Economic Perspectives on Innovation*, 76 CAL. L. REV. 803, 843 (1988). Professor Robert Merges noted that Schumpeter's theory is based upon the following assumptions:

> (1) capitalist economies are characterized by a continuous process of 'creative destruction' in which innovative technologies and organizational structures constantly threaten the status quo; [and] (2) technological innovation provides the opportunity for temporary monopoly profits, and the pursuit of these profits has spurred the tremendous growth of the Western economies.

Merges, *supra*, at 843.

2. *See infra* note 14 and accompanying text.

The potential competition doctrine is one approach by which to analyze dynamic markets.[3] Federal courts applying the doctrine have tried to assess the competitive significance of a spectator firm's mere presence as well as the prospective effect were it to enter the market.[4] However, antitrust analysis of these issues is not limited to this doctrine. Entry analysis of mergers, monopolization, and even predatory pricing are other areas where these same issues are explored. Depending on how they are employed, these concepts can undergird an antitrust plaintiff's or defendant's case.

Despite the relevance of these antitrust tools to nascent markets, their application has been obscured.[5] While the potential competition doctrine and entry concepts in antitrust cases generally address the same issues, courts have applied different standards depending on the antitrust violation or the party (plaintiff or defendant). And, with respect to the potential competition doctrine, courts have developed two variants of the doctrine. Unfortunately, both variants of the doctrine have grown unwieldy and obscure. Beyond varying and unwieldy standards, courts have used similar evidence to reach completely disparate results. Indeed, some cases have ignored the doctrine altogether, using more expansive concepts of competition to analyze antitrust claims.

The growing acceptance by antitrust enforcers and courts of the defensive uses of the potential competitor concept in antitrust matters has only compounded the confusion. For example, in a merger between two firms in an industry where only three market participants exist, it is commonplace for the merging parties to argue that other potential competitors exist.[6] Again, court application of this defensive tack is anything but consistent with the affirmative uses of the potential competition doctrine.

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3. As many commentators have observed, the term "potential competition" is a misnomer because a "potential competitor" often constrains prices and service, and fosters innovation, even if it is not presently a supplier in the marketplace. *See, e.g.*, HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE § 13.4 (2d ed. 1999).

4. Antitrust commentators have long recognized both of the competitive benefits discussed here as candidate theories of anticompetitive effects. *See, e.g.*, PHILLIP E. AREEDA & HERBERT HOVENKAMP, 5 ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1121a (2d ed. 2003).

5. *See* Andrew S. Joskow, *Potential Competition: The Bell Atlantic/NYNEX Merger*, 16 REV. INDUS. ORG. 185, 189 (2000) (stating that potential competition cases are so rare that they are "virtually absent from antitrust").

6. In one of the most recent suits brought by the DOJ to block a merger, *United States v. Sungard Data Systems, Inc.*, the defendants argued that a number of entrants would quash any attempted anticompetitive behavior from the proposed merger. 172 F. Supp. 2d 172, 174 (D.D.C. 2001). The district court ultimately ruled against the DOJ without addressing the issue of entry. *See id.* at 193.

In this Article, we offer a new approach to dynamic markets where firms on the edge of the market may have an impact on that market. Above all, our approach provides a more consistent test that is applicable across all types of antitrust violations and is applicable to both plaintiffs and defendants. Our approach also develops a test that focuses on the two critical elements of potential entry: the likelihood of actual entry and the nature of the competitive effect. As the certainty of actual entry declines, the evidence of current, ongoing effects in the market becomes necessary. We stress, however, that other factors affect the outcome of this axiom, such as whether the antitrust defendant is responsible for preventing entry. Finally, our approach to the concept of potential competition analyzes objective and subjective evidence. While courts and federal antitrust agencies have emphasized objective evidence in their analysis of these issues, we believe that relying on entirely objective evidence is undesirable.

We set our course for this discussion in Part I, where we frame the concept of potential competition in the economic literature. We also spend some time discussing the development of contestable market theory. Part II surveys the potential competition and entry cases, the federal antitrust guidelines governing the potential competition doctrine, and the cases and administrative proceedings in deregulating industries that discuss potential competition. We draw from the electricity, airline, telecommunications, banking, and railroad sectors for illustration. Part III begins by presenting a critique of the cases, taking into account the observations of other commentators. We then lay out the approach we advocate, explaining how we address the deficiencies of the current legal regime. In Part IV, we take our approach for a test drive by presenting various hypothetical fact patterns to explain how our approach works and how it differs from the current state of the law. Finally, we conclude in Part V with a summary of our approach.

I. POTENTIAL COMPETITION AND ENTRY IN THE ECONOMIC LITERATURE

While potential competition issues arose in the early case law of the Sherman Act,[7] the potential competition doctrine was not solidified

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7. *See, e.g.*, Standard Oil Co. of N.J. v. United States, 221 U.S. 1 (1911). Pipelines, at their inception, were curious potential competitors of John D. Rockefeller's railroad cartel. While consumers were, in the first instance, suspicious as to whether the pipelines would be able to transport the product, such suspicion did not prevent Rockefeller from attempting to block the pipelines' entry at every stage. *See id.* at 32–43. In order to break up Rockefeller's stranglehold over gas transportation (both by rail car and by pipe), Congress passed a statute in 1906 requiring open access. *See* Farmers Union Cent. Exch. v. FERC, 734 F.2d 1486, 1492–93 (D.C. Cir. 1984).

within the mainstream economic literature[8] until the 1950s.[9] In 1956, Professor Joe S. Bain developed his analysis of entry barriers.[10] Bain linked entry barriers to the degree to which potential competition could constrain incumbents in their pricing decisions.[11] Bain also identified numerous barriers that could constrain entry and threats of entry, including economies of scale, cost advantages, and product differentiation.[12] Bain's analysis led to a sophisticated economic modeling of limit pricing behavior. "A firm is limit pricing if it sets its price and output so that there is not enough demand left for another firm to enter the market profitably."[13]

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8. Ironically, before the passage of the Sherman Act, potential competition was used as an analogy for why the Sherman Act should *not* be passed:

> Potential public action, like potential competition, keeps extortion within bounds. One actual decision, one actual limiting statute, has the effect of holding a lash over all organizations of the kind that it actually strikes. What we now see is the beginnings of the process,—a few decisions, many bills not yet passed, some tentative work with commissions. But these mere beginnings suffice to throw some restraint on the action of monopolies.

HANS B. THORELLI, FEDERAL ANTITRUST POLICY: ORIGINATION OF AN AMERICAN TRADITION 123 n.49 (1954) (quoting John Bates Clark, *The "Trust": A New Agent for Doing an Old Work: Or Freedom Doing the Work of Monopoly*, 16 NEW ENGL. & YALE REV. 223, 228 (1890)).

9. Because of the early antitrust fascination with trusts, many of the economic ideals surrounding potential competition and entry had been discussed to some degree in the early stages of antitrust enforcement. *See* William G. Shepherd, *Potential Competition Versus Actual Competition*, 42 ADMIN. L. REV. 5, 9–10 (1990); *see also* RICHARD T. ELY, MONOPOLIES AND TRUSTS (1900); ALFRED MARSHALL, INDUSTRY AND TRADE (3d ed. 1920); Henry C. Adams, *Trusts*, *in* 5 PUBL'NS AM. ECON. ASS'N, May 1904, at 91; Charles J. Bullock, *Trust Literature: A Survey and a Criticism*, 15 Q.J. ECON. 167 (1901); John B. Clark, *The Limits of Competition*, 2 POL. SCI. Q. 45 (1887). This literature was developed to a more sophisticated degree in the 1930s and 1940s. *See Investigation of Concentration of Economic Power: Hearings Before the Temp. Nat'l Econ. Comm.*, 75th Cong. pt. 30 (Arno Press & N.Y. Times 1971) (1940); ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (Rev. ed. 1968); JOAN ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION (1933); JOHN VON NEUMANN & OSKAR MORGENSTERN, THEORY OF GAMES AND ECONOMIC BEHAVIOR (3d ed. 1953).

10. JOE S. BAIN, BARRIERS TO NEW COMPETITION: THEIR CHARACTER AND CONSEQUENCES IN MANUFACTURING INDUSTRIES (1956).

11. *Id.* at 94; *see also* JOE S. BAIN, INDUSTRIAL ORGANIZATION 8 (2d ed. 1968) (stating that entry conditions "determine[] the relative force of potential competition as an influence or regulator on the conduct and performance of sellers already established in a market"); Joe S. Bain, *A Note on Pricing in Monopoly and Oligopoly*, 39 AM. ECON. REV. 448, 452 n.7 (1949).

12. *See* Richard J. Gilbert, *The Role of Potential Competition in Industrial Organization*, 3 J. ECON. PERSP. 107, 108 (1989).

13. DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 343 (3d ed. 2000) (emphasis omitted); *see also* Franco Modigliani, *New Developments on the Oligopoly Front*, 66 J. POL. ECON. 215, 230 (1958). A firm may do this over time, such that "incumbent firms can trade off the current profitability

Bain's analysis also led Professors William J. Baumol, John C. Panzar, and Robert D. Willig to pioneer contestable market theory,[14] when Bain's analysis was combined with the works of early game theorists[15] and others.[16] Essentially, the contestable market theory asserts that the traditional assumptions of perfect competition in economics are unnecessary in order to discipline price.[17] Potential entry can discipline price down to competitive levels—even when only one or a few firms are producing a product—if entry into the market is free and quick (the entering firm incurs no sunk costs and can enter at any size)[18] and exit is equally free and painless.[19] Contestable market theory also requires that the market not respond to the entrant's entry: the market price remains static for the period of entry.[20] Thus, contestable markets

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against the prospect that high profits today will increase the rate at which new competition is attracted to the industry." Gilbert, *supra* note 12, at 110.

14. WILLIAM J. BAUMOL, JOHN C. PANZAR & ROBERT D. WILLIG, CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE (1982); *see also* William J. Baumol, *Contestable Markets: An Uprising in the Theory of Industry Structure*, 72 AM. ECON. REV. 1 (1982) [hereinafter Baumol, *Uprising*].

15. AUGUSTIN COURNOT, RESEARCHES INTO THE MATHEMATICAL PRINCIPLES OF THE THEORY OF WEALTH (2d ed. 1927); J. Bertrand, *Théorie Des Richesses*, 1883 JOURNAL DES SAVANTS 499 (reviewing LÉON WALRAS, THÉORIE MATHÉMATIQUE DE LA RICHESSE SOCIALE (1883), and AUGUSTIN COURNOT, RECHERCHES SUR LES PRINCIPES MATHÉMATIQUES DE LA THÉORIE DES RICHESSES (1838)).

16. *See, e.g.*, Harold Demsetz, *Why Regulate Utilities?*, 11 J.L. & ECON. 55 (1968).

17. *See* Elizabeth E. Bailey & William J. Baumol, *Deregulation and the Theory of Contestable Markets*, 1 YALE J. ON REG. 111, 112-115 (1984) (contrasting perfect competition with perfect contestability). Perfect competition occurs in an industry where "all firms produce homogeneous, perfectly divisible output and face no barriers to entry or exit; producers and consumers have full information, incur no transaction costs, and are price takers; and there are no externalities." CARLTON & PERLOFF, *supra* note 13, at 57 (noting that many economists also assume a large number of buyers and sellers). Firms in contestable markets "need not be small or numerous or independent in their decision making or produce homogeneous products." Baumol, *Uprising*, *supra* note 14, at 4.

18. We use "freedom of entry" . . . [to mean] that the entrant suffers no disadvantage in terms of production technique or perceived product quality relative to the incumbent, and that potential entrants find it appropriate to evaluate the profitability of entry in terms of the incumbent firms' pre-entry prices. In short, it is a requirement of contestability that there be no cost discrimination against entrants.

Baumol, *Uprising*, *supra* note 14, at 3-4.

19. "By this we mean that any firm can leave without impediment, and in the process of departure can recoup any costs incurred in the entry process." *Id.* at 4.

20. Bailey & Baumol, *supra* note 17, at 114 ("A contestable market works most effectively if, in response to a profitmaking opportunity, new firms can enter quickly, earn profits at least temporarily (before incumbents can institute countermeasures) and then leave without any loss of investment in sunk capital."). This appears to be a heroic assumption. "Even with only a tiny price advantage, the entrant

are said to be subject to "hit-and-run entry": any price increase by an incumbent firm could be captured by instantaneous entry.[21] An entrant could then proceed to exit before the incumbent responds.[22] Ironically, this theory was almost immediately applied to the airline industry, where incumbent response is mercilessly quick.[23]

The welfare implications of contestability are thus similar to those found in perfectly competitive markets. Firms in contestable markets receive the normal rate of profit, are efficient—in terms of allocative efficiency, productive efficiency, and long-run technological efficiency[24]—and charge prices equal to marginal cost in the long run.[25]

Thus, markets where entry was "easy" could be viewed as competitive even where the incumbent firms had large market shares. Conversely, in markets where entry is difficult and little or no incumbent competition exists, potential competition may be the only disciplining mechanism that protects social welfare.[26] For this reason, potential competition was viewed as an important mechanism in protecting consumers and, at least at the inception of the doctrine, mergers between potential rivals were viewed with a jaundiced eye.[27]

This economic analysis also extends to concepts such as innovation. During the 1990s, antitrust enforcers began to recognize the importance of innovation and perhaps the existence of innovation competition. The concept is invariably tied to entry. As two commentators have put it, "[i]nnovation resulting from vigorous research and development is often

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will prevail totally, with no interaction or sequence of competitive moves." Shepherd, *supra* note 9, at 17.

21. Bailey & Baumol, *supra* note 17, at 114–15.

22. *Id.*

23. Professor William Baumol revisited the issue of the contestability of airline markets. He concluded that airline markets were not contestable, although he held out hope that they would soon be contestable. *See id.* at 127–32. History has demonstrated that his hope was misplaced. *See* Severin Borenstein, *Airline Mergers, Airport Dominance, and Market Power*, 80 AM. ECON. REV. 400 (1990) (noting that airport dominance limits entrants' ability to attract passengers); Severin Borenstein, *Hubs and High Fares: Dominance and Market Power in the U.S. Airline Industry*, 20 RAND J. ECON. 344 (1989) (limited effect from potential competition); Eli A. Friedman, *Airline Antitrust: Getting Past the Oligopoly Problem*, 9 U. MIAMI BUS. L. REV. 121 (2001); Michael E. Levine, *Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy*, 4 YALE J. ON REG. 393 (1987).

24. *See* F.M. Scherer, *Antitrust, Efficiency, and Progress*, 62 N.Y.U. L. REV. 998 (1987) (discussing various types of efficiencies).

25. Baumol, *Uprising*, *supra* note 14, at 4.

26. *See* LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK § 11.3b–.3b1 (2000).

27. There was, of course, a backlash effect in the economic literature. *See, e.g.*, Roger Sherman & Thomas D. Willett, *Potential Entrants Discourage Entry*, 75 J. POL. ECON. 400 (1967); *see also* Joseph F. Brodley, *Potential Competition Under the Merger Guidelines*, 71 CAL. L. REV. 376, 383 & n.39 (1983) (discussing arguments against limit pricing).

the precursor to entry in markets characterized by sophisticated and rapidly evolving technology."[28] Thus, elimination of competition in innovation markets may lead to the elimination of competition in product markets.[29]

Elimination of potential product competition may result from the acquisition of a rival's intellectual property, the acquisition of the rival or an agreement to enter into a joint venture. The effect of such conduct is two-fold. First, it eliminates actual competition in innovation: insofar as this is a fundamental antitrust value, injury to innovation would be a sufficient basis for an antitrust claim.[30] Second, as we have explained, the elimination of potential competition in the offering of competing products may also injure consumers.[31]

The doctrine of potential competition and antitrust entry analysis posit that even concentrated firms may be subject to the disciplining effects of a competitor waiting in the wings. Where markets are concentrated, the ability of a firm to force incumbents to set their price

28. Richard J. Gilbert & Steven C. Sunshine, *Incorporating Dynamic Efficiency Concerns in Merger Analysis: The Use of Innovation Markets*, 63 ANTITRUST L.J. 569, 570 (1995).

29. *Id.*; *see also* Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962) ("The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."). In other words, the product market defines the contours of competition between competing commodities.

30. *See* John J. Flynn, *Antitrust Policy, Innovation Efficiencies, and the Suppression of Technology*, 66 ANTITRUST L.J. 487 (1998) (arguing that innovation is a value protected under the Sherman Act); *see also* Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020 (1987). Professor Joseph F. Brodley suggests that antitrust enforcement values pricing efficiency in output markets and ignores practices aimed at eliminating innovation efficiencies, at least at the time he wrote the article. *See* Brodley, *supra*, at 1031–32. The antitrust enforcement agencies have since indicated a heightened awareness of innovation markets, as is evidenced in their willingness to recognize gains from collaborations. *See* FTC & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS (2000) [hereinafter AGCAC], *reprinted in* JOHN J. FLYNN, HARRY FIRST & DARREN BUSH, ANTITRUST: STATUTES, TREATIES, REGULATIONS, GUIDELINES, POLICIES (2001); *see also Innovation, Rivalry and Competitive Advantage: Interview with Michael E. Porter*, 5 ANTITRUST, Spring 1991, at 5 [hereinafter *Innovation, Rivalry, and Competitive Advantage*]. As Professor Michael E. Porter explained:

> The central focus of antitrust policy . . . ought to be on fostering progressiveness, defined broadly to include not only technological innovation but new ways of competing in product, marketing, service, and so on. When faced with tradeoffs, we should weigh progressiveness much higher than static efficiency or a snapshot of price-cost margins.

Innovation, Rivalry and Competitive Advantage, *supra*, at 5. The benefits of innovation may include reductions in costs to producers, and reductions in prices and greater choices in product to consumers.

31. *See supra* text accompanying note 26.

at a rate that is less than a monopolist or oligopolistic rate creates efficiencies for consumers. The economic literature affirms these principles. As will be discussed in the next Part, this notion of efficiencies derived from potential competition has played a significant role in antitrust enforcement; however, its role significantly declined during the 1980s and 1990s. During this decline, entry analysis, which relies on these same principles, grew in prominence as a defensive tactic to combat antitrust plaintiffs. Another approach, under which markets were described so expansively that they avoided the concept of potential competition altogether, also became more prominent during this time.

II. POTENTIAL COMPETITION IN THE LAW

Our survey of the law is a systemic attempt to root out the problems in the cases that apply the concepts of entry and potential competition. Before we start this survey, we provide an overview of the applicable antitrust laws and the applications of potential competition or entry concepts. We then turn to the cases and federal agency antitrust guidelines involving mergers, contracts or agreements between firms, monopolization, and various applications in industries experiencing deregulation. Our deregulation discussion examines the electricity, airline, telecommunications, banking, and railroad industries. We also include administrative decisions where relevant.

A. *Overview of Antitrust Doctrine and Potential Competitors*

The concept of the potential competitor is both a sword and a shield in antitrust litigation. For example, the existence of a firm that could be in a position to enter a new market is one that may assist in the building of an antitrust violation case—if that potential competitor is being acquired. Alternatively, the existence of the potential competitor could destroy a case as well—the potential entrant mitigates the anticompetitive effects of a merger. Indeed, as the following table demonstrates, potential competition is important for nearly all conduct relevant to the three primary antitrust statutes, and could be used as either a plaintiff's theory or a defense.[32]

32. Potential competition is irrelevant as a defense to only one class of antitrust violations: per se cases. Certain conduct has been presumed anticompetitive under the antitrust laws. Under these situations, a plaintiff need only show that the conduct actually occurred. One clear example is an agreement by competitors to fix prices or other terms closely related to price. Under these circumstances, the existence or absence of potential competitors is completely irrelevant to a finding of illegality. *See* Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980). Per se treatment is also accorded to agreements between competitors to divide markets. *See* Palmer v. BRG of Ga., Inc., 498 U.S. 46 (1990).

	Clayton Act § 7[33]	**Sherman Act § 1**[34]	**Sherman Act § 2**[35]
Plaintiff's Theories	Acquisition affects future competition because the target is an entrant	Consumer harm due to per se restraint of trade between competitor and uncommitted entrant	Conduct thwarting potential competitors maintains a monopoly
Defendant's Theories	Potential competitors restrict the merged firm's ability to raise prices	Alleged restraint of trade is between vertical elements and is therefore subject to the rule of reason	Potential competitors would thwart exclusionary behavior against other rivals

Section 7 of the Clayton Act prohibits mergers that may "substantially . . . lessen competition" or that "tend to create a monopoly."[36] The statute is preventative; it strives to stop future anticompetitive conduct that may result from a merger in its incipiency.[37] In the language of the U.S. Supreme Court, section 7 is designed to "nip monopoly in the bud."[38] As a practical matter, section 7 enforcement attempts to prevent unilateral or coordinated anticompetitive effects.[39] Potential competitors are an important factor

33. 15 U.S.C. § 18 (2000).

34. *Id.* § 1.

35. *Id.* § 2.

36. *Id.* § 18.

37. *See* United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 589 (1957).

38. *Id.* at 592-93 (quoting Transamerica Corp. v. Bd. of Governors, 206 F.2d 163, 169 (3d Cir. 1953)).

39. Unilateral effects refer to anticompetitive effects that a firm can undertake independently because it has market power as a result of a merger. In contrast, coordinated effects refer to the increased possibility that collusive behavior between firms will occur as a result of a merger. Robert H. Bork and Judge Richard A. Posner emphasize the latter point in their overviews of merger enforcement. ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 221-22 (1993); RICHARD A. POSNER, ANTITRUST LAW 101-17 (2d ed. 2001). The DOJ also seems to have taken a new interest in coordinated effects. *See* Charles A. James, Assistant Attorney General, U.S. Dep't of Justice, Rediscovering Coordinated Effects, Address at the ABA Annual Meeting (Aug. 13, 2002), *available at* http://www.usdoj.gov/atr/public/speeches/200124.htm; William J. Kolasky, Deputy Assistant Attorney General, U.S. Dep't of Justice, Coordinated Effects in Merger Review: From Dead Frenchmen to Beautiful Minds and Mavericks, Address at the ABA

to consider in assessing the competitive effects of a merger. Acquisitions of potential competitors may eliminate a very important form of competition in a highly concentrated industry. Alternatively, the existence of many possible entrants may mitigate any anticompetitive effects arising from a combination between two of only a few incumbent firms in an industry.

Section 1 of the Sherman Act governs concerted actions by competitors that cause economic harm.[40] Uncommitted competitors are often relevant in determining whether there is a per se section 1 violation. For example, a group boycott between horizontal competitors is a per se violation of section 1.[41] However, if the group is comprised of a buyer and a seller, the group is vertical in nature and the boycott would likely be subject to the rule of reason.[42] Under the rule of reason, courts weigh the enhancements in efficiency from the agreement between the firms against their anticompetitive effects.[43] Thus, the determination of the relationship between an incumbent and a potential entrant is essential for a judicial calculation of what types of defenses, justifications, and excuses might be admitted into evidence.

A similar analysis of potential competitors applies to section 2 claims under the Sherman Act, which governs a firm's efforts to monopolize a market by illegal means.[44] For example, a monopolist may attempt to sign long-term exclusivity contracts with its suppliers in order to lock out potential rivals from having the ability to produce the

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Section of Antitrust Law Spring Meeting (Apr. 24, 2002), *available at* http://www.usdoj.gov/atr/public/speeches/11050.htm.

40. 15 U.S.C. § 1.

41. Horizontal competitors are competitors that offer products on the same market level. Val D. Ricks & R. Chet Loftis, *Seeing the Diagonal Clearly: Telling Vertical from Horizontal in Antitrust Law*, 28 U. TOL. L. REV. 151, 156 (1996).

42. *See* Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 59 (1977); *see also* AGCAC, *supra* note 30, § 1.2.

43. As the *Antitrust Guidelines for Collaborations Among Competitors* state:

> Rule of reason analysis focuses on the state of competition with, as compared to without, the relevant agreement. The central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.
>
> Rule of reason analysis entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances. The Agencies focus on only those factors, and undertake only that factual inquiry, necessary to make a sound determination of the overall competitive effect of the relevant agreement. Ordinarily, however, no one factor is dispositive in the analysis.

AGCAC, *supra* note 30, § 1.2.

44. 15 U.S.C. § 2.

product. Alternatively, a monopolist might argue that such long-term exclusivity contracts are not harmful to competition because most would-be competitors could produce the product using other suppliers or other inputs.

While the impact that nonincumbent firms have on the marketplace often binds these arguments together, the law has failed to treat these circumstances consistently, and it has used a confusing nomenclature, which we will now introduce. The courts have treated potential competition under effectively three different names, using four different approaches.

First, when used in an affirmative section 7 case, courts have developed two different legal concepts that are driven by the type of competitive effects the potential entrant causes. When the transaction or conduct is aimed at a potential competitor that is constraining market prices or having some other current, ongoing procompetitive effect, courts apply the perceived potential competition doctrine. For example, courts find that perceived potential competition is present when competitors in a highly concentrated market are aware of the potential competitor and have adjusted their pricing in a more competitive manner to perhaps deter that firm's entry.

The other concept relevant for a plaintiff's section 7 theory is the actual potential competition doctrine. Actual potential competition occurs when the potential competitor is not having a present procompetitive effect on the market, but considerable evidence exists that the uncommitted firm is going to enter the market. The competitive effect from actual potential competition occurs in the future. The reasoning for finding an antitrust violation is that. but for a merger or some anticompetitive conduct, the firm would have entered and brought lower prices, better service or an innovative product to the market. The actual potential competition doctrine rests on a less sound legal foundation because the Court has failed to expressly recognize this concept.[45]

To add another layer of confusion, some courts—and plaintiffs—have preferred to tread down a third path that treats potential competitors as if they were actually competing in the market by defining the market in very broad terms. In these cases, the potential competitor could innovate or market the product it now sells in a manner that would compete with the incumbents. For example, a glass bottle manufacturer could, through simple modifications, marketing or technological innovations, make a jar that competes with a metal container manufacturer that produces soup cans. In this case, a court may simply

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45. *See* United States v. Marine Bancorporation, Inc., 418 U.S. 602, 639 (1974); United States v. Falstaff Brewing Corp., 410 U.S. 526, 537 (1973).

elect to treat glass and metal container manufacturers as incumbents in the same market rather than a potential entrant. While this result may not necessarily be antithetical to a court's application of the potential competitor doctrine, it is nonetheless another approach.

Finally, uncommitted competition is relevant to the concept of entry for defensive purposes.[46] Future entry by firms may mitigate the competitive effects of a merger or render an otherwise restrictive agreement legal. With the exception of per se violations of section 1 of the Sherman Act, courts have recognized that if other firms are able to enter the market, anticompetitive effects may be mitigated entirely. While common themes run throughout the antitrust case law discussion, the case law is quite divergent with respect to entry, depending upon the section under which the action is brought.

B. *Section 7 of the Clayton Act*

In our discussion of the section 7 cases, we focus first on the U.S. Supreme Court's approaches toward the concept of potential competition for showing an antitrust violation. We then examine the lower courts' applications of these doctrines, discussing the conflicts and agreements in the law. The third section discusses the recent trends in the case law. Our final section discusses the defensive uses of potential competition.

1. U.S. SUPREME COURT JURISPRUDENCE

Perhaps because the bidding process exhibits one of the most tangible competitive effects of potential entry, the Court first explicitly

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46. We of course recognize that antitrust plaintiffs must typically also deal with the concept of entry by showing that entry barriers exist in the market. *See* FTC, STATEMENT CONCERNING HORIZONTAL MERGERS (1982), *reprinted in* ABA ANTITRUST SECTION, MONOGRAPH NO. 12, HORIZONTAL MERGERS: LAW AND POLICY 302 (1986).

> The issue of entry barriers is perhaps the most important qualitative factor, for if entry barriers are very low it is unlikely that market power, whether individually or collectively exercised, will persist for long. Conversely, if entry barriers are quite high, the effect may be to exacerbate any market power conferred by the merger. Of course, the evidence relating to entry barriers may not always point clearly to the conclusion that a merger should or should not be allowed. On the other hand, evidence of actual entry, especially recent and frequent new entry, is highly probative, as is evidence of failed entry or the absence of entry over long periods of time. Besides mere entry, effective competition might also depend upon a firm's achieving a certain scale of operation. Evidence of substantial expansion by firms already in an industry, especially nondominant firms, may persuasively indicate that barriers to larger scale are not high. Conversely, evidence of frequent entry, but on a small scale, without significant expansion by fringe firms, may also suggest the existence of barriers to larger scale.

Id. (footnote omitted).

recognized the perceived potential competition doctrine in 1964.[47] *United States v. El Paso Natural Gas Co.* is the first significant section 7 case that addressed the concept squarely.[48] El Paso Natural Gas ("El Paso") planned to acquire Pacific Northwest Pipeline Corporation ("Pacific Northwest").[49] While less than half of California's natural gas needs were supplied from sources within the state, El Paso was the sole out-of-state supplier, providing more than 50% of the gas in the state.[50] Demand for natural gas in the state was rapidly expanding.[51]

Pacific Northwest operated pipelines around California, from New Mexico to Washington.[52] While its physical network of pipelines did not directly deliver product to the state, its lines in Oregon were about 250 miles away.[53] Pacific Northwest had bid to supply natural gas to California's largest industrial user of natural gas, Southern California Edison Company ("Edison").[54] Edison had received gas from El Paso through another gas distributor.[55] El Paso's service was inferior because El Paso only provided interruptible gas service through its distributors, at prices above the rates that Pacific Northwest was willing to offer on a firm (noninterruptible) basis.[56] Pacific Northwest and Edison reached a tentative agreement that required the construction of gas lines that would enable delivery of the product into California.[57] While El Paso fought these construction plans throughout the regulatory process, it also began renegotiating with Edison.[58] During the course of these negotiations, Edison was able to reduce El Paso's gas prices by 25% and prevailed in getting El Paso to provide firm deliveries of gas, rather than an interruptible supply.[59]

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47. Prior cases involving mergers have touched upon the concept of potential competition, but never in the systemic way that the U.S. Supreme Court has discussed it. *See, e.g.*, United States v. Columbia Steel Co., 334 U.S. 495, 528–29 (1948) (discussing potential competition briefly); N. Sec. Co. v. United States, 193 U.S. 197, 325–26 (1904) (considering, in a section 1 case, whether two railroads placed in a trust were actually competing with each other prior to the creation of the trust in spite of their ability to compete).

48. 376 U.S. 651 (1964).

49. *Id.* at 655.

50. *Id.* at 652 & n.2.

51. *Id.* at 654.

52. *Id.* at 653.

53. *Id.* at 661.

54. *Id.* at 654.

55. *Id.*

56. *Id.* at 654–55.

57. *Id.* at 655.

58. *Id.*

59. *Id.* Years later, Northwest Pipeline entered the California market. *See* Steven W. Snarr, *Deregulation of Natural Gas Utilities: A Proposal for Legislative Reform in State Utility Regulation*, 11 J. ENERGY NAT. RESOURCES & ENVTL. L. 199, 201 (1991).

On these facts, the Court found that Pacific Northwest was "a substantial factor in the California market."[60] The Court explained the significance of Pacific Northwest in the California market by examining the competitive effects from its negotiations with Edison:

> Edison's search for a firm supply of natural gas in California, when it had El Paso gas only on an "interruptible" basis, illustrates what effect Pacific Northwest had merely as a potential competitor in the California market. Edison took its problem to Pacific Northwest and, as we have seen, a tentative agreement was reached for Edison to obtain Pacific Northwest gas. El Paso responded, offering Edison a firm supply of gas and substantial price concessions. We would have to wear blinders not to see that the mere efforts of Pacific Northwest to get into the California market, though unsuccessful, had a powerful influence on El Paso's business attitudes within the State.[61]

The fact that Pacific Northwest did not have any market share in California and was locked out of the current Edison gas distribution contract was irrelevant. Pacific Northwest would have continuing opportunities to compete because "new increments of may emerge" from the growth of the California market.[62] "Unsuccessful bidders are no less competitors than the successful one. The presence of two or more suppliers gives buyers a choice."[63]

In *El Paso*, the Court failed to set out a specific test for establishing a potential competition claim. The Court's closest enunciation of a test was that "[t]he effect on competition in a particular market through acquisition of another company is determined by the nature or extent of that market and by the nearness of the absorbed company to it, that company's eagerness to enter that market, its resourcefulness, and so on."[64]

Subsequent cases built on the foundation of *El Paso*. In *United States v. Penn-Olin Chemical Co.*, the Court used the same language in *El Paso* and emphasized that "[p]otential competition cannot be put to a subjective test."[65] The Court in *Penn-Olin* provided a clearer rationale for what would become the perceived potential competition doctrine, quoting from a monograph that

60. *El Paso*, 376 U.S. at 658.
61. *Id.* at 659.
62. *Id.* at 660 (emphasis omitted).
63. *Id.* at 661.
64. *Id.* at 660.
65. 378 U.S. 158, 174 (1964).

> [p]otential competition . . . as a substitute for . . . [actual competition] may restrain producers from overcharging those to whom they sell or underpaying those from whom they buy. . . . Potential competition, insofar as the threat survives . . . may compensate in part for the imperfection characteristic of actual competition in the great majority of competitive markets.[66]

The *Penn-Olin* case also represented a distinct expansion of the doctrine. In *El Paso*, the potential entrant's effect on the market was through an unsuccessful bid.[67] In contrast, *Penn-Olin* involved a joint venture to produce and sell sodium chlorate between two firms: one firm never served the geographic market that the joint venture would serve; the other never produced the chemical that was the relevant product.[68]

Pennsalt produced sodium chlorate as well as a number of other chemicals, but did not directly distribute the product to the growing southeastern market.[69] Olin, which patented the process that spurred demand for sodium chlorate in the pulp and paper industry, distributed the chemical for Pennsalt in the southeast, but did not produce it at all.[70] Apparently, the market for sodium chlorate was a relatively concentrated one; including the joint venture, only three firms produced sodium chlorate in the southeast.[71] In spite of the growth in demand for this chemical, the Court observed that no new entry occurred for a decade prior to the joint venture.[72] However, after the joint venture was announced, a firm that was producing the chemical in Canada planned to open a plant in the southeast.[73] Both Pennsalt and Olin had considered entering this market independently, but they ultimately decided to form a joint venture instead.[74]

The district court evaluated whether the potential competition doctrine was applicable by trying to determine whether "as a matter of reasonable probability both Pennsalt and Olin would have built plants in

66. *Id.* (quoting STAFF OF SENATE TEMP. NAT'L ECON. COMM., 76TH CONG., INVESTIGATION OF CONCENTRATION OF ECONOMIC POWER: COMPETITION AND MONOPOLY IN AMERICAN HISTORY 7-8 (Comm. Print 1941)).
67. *See* 376 U.S. at 654-55, 658.
68. 378 U.S. at 160-63.
69. *See id.* at 161-62.
70. *Id.*
71. *Id.* at 163.
72. *Id.* at 164.
73. *See id.* at 165.
74. *Id.* at 165-66.

the southeast if Penn-Olin had not been created."[75] The Court found the district court's test misplaced, explaining that the relevant inquiry should have also included

> consideration [of] the fact that Penn-Olin eliminated the potential competition of the corporation that might have remained at the edge of the market, continually threatening to enter. Just as a merger eliminates actual competition, this joint venture may well foreclose any prospect of competition between Olin and Pennsalt in the relevant sodium chlorate market."[76]

The Court found ample evidence that each firm was a potential entrant in the market in a number of factors. Both Olin and Pennsalt had the know-how to enter the market, had established customer relationships, and had a strong interest and incentive to enter the market.[77] However, as the Court acknowledged, the finding that Pennsalt and Olin were potential competitors was not enough to prove that the transaction may have substantially lessened competition, as section 7 required.[78] In *El Paso*, the Court had the benefit of direct evidence of the anticompetitive effects of El Paso's acquisition of Pacific Northwest: Pacific Northwest's bid forced El Paso to lower its prices on at least one occasion.[79]

On the question of competitive effects, the Court conceded, "it is impossible to demonstrate the precise competitive effects of the elimination of either Pennsalt or Olin as a potential competitor."[80] The Court established a number of criteria that a court should take into account to assess whether competitive harm has occurred.[81] Those factors included the structure and history of the market, the competition between the two firms themselves, the reasons for the merger or joint venture, and an assessment of what competition would have looked like in the market if the venture did not exist.[82] And, the Court noted that "[t]he existence of an aggressive, well equipped and well financed corporation engaged in the same or related lines of commerce waiting anxiously to enter an oligopolistic market would be a substantial incentive to competition which cannot be underestimated."[83]

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75. United States v. Penn-Olin Chem. Co., 217 F. Supp. 110, 130 (D. Del. 1963) (emphasis omitted).

76. *Penn-Olin*, 378 U.S. at 173.

77. *Id.* at 175.

78 *See id.* at 175–77.

79. *See El Paso*, 376 U.S. at 655.

80. *Penn-Olin*, 378 U.S. at 176 (emphasis omitted).

81. *Id.* at 176–77.

82. *Id.*

83. *Id.* at 174.

Penn-Olin expanded the concept of potential competition to situations where one of two potential entrants actually enters the market as a result of a joint venture with the other.[84] The cases immediately following *Penn-Olin* supported an even more expansive view of potential competition. In *FTC v. Procter & Gamble Co.*, the Court found that Procter & Gamble Company ("Procter"), as a potential competitor in the market for household bleach, violated section 7 by acquiring Clorox, the largest manufacturer of household bleach.[85]

In *Procter & Gamble*, the Court found that Procter was likely to enter into the market for household bleach.[86] Like *Penn-Olin*, the Court relied on a number of factors that tended to show that Procter had the ability and incentive to enter the bleach market on its own or through a much smaller toehold acquisition, rather than through acquiring Clorox, which sold 50% of all household bleach.[87] Procter had considered entering the market through acquisition or through internal expansion.[88] It decided against internal expansion "because the acquisition of Clorox would enable Procter to capture a more commanding share of the market."[89] Moreover, the Court found the market to be concentrated.[90]

Based on its conclusion that the market was concentrated and that Procter would enter the market, the Court found the transaction had produced two possible anticompetitive effects.[91] First, Procter exerted influence on market prices when it was not producing bleach at all because "the market behavior of the liquid bleach industry was influenced by each firm's predictions of the market behavior of its competitors, actual and potential."[92] In other words, since Procter was viewed by the industry as a firm that might begin producing bleach,

84. Posner, for example, criticizes the Court's conclusion. He asserts that if one of the firms, Olin, for example, did not enter while the other did, the firms in the market "would have drastically discounted the significance of the nonentrant as a possible future competitor." POSNER, *supra* note 39, at 139.

85. 386 U.S. 568 (1967).

86. *Id.* at 573.

87. *Id.* at 577–81.

88. *Id.* at 574.

89. *Id.* at 580–81.

90. *Id.* at 578. Many critics have assailed this conclusion, especially because there were six major producers that sold 80% of all bleach and 200 very small producers of household bleach that produced the remaining 20%. *See, e.g.*, BORK, *supra* note 39, at 259–60. In spite of these critiques, the Court's action may have provided a benefit for consumers it did not foresee: over the years, Clorox has introduced products that have competed with Procter & Gamble. *See, e.g.*, Geoffrey A. Fowler, *Towels, Soap, Sponges and Mops, Look Out: Here Come the Wipes: From Baby's to Buster's Bottom, There's One for Any Occasion; The Lazy Person's Cleanup*, WALL ST. J., Aug. 31, 2001, at B1; Chip Johnson, *Clorox Is Stained with Pretax Charge of $125 Million to End Detergent Line*, WALL ST. J., May 20, 1991, at B7.

91. *Procter & Gamble*, 386 U.S. at 578.

92. *Id.* at 581.

firms already producing bleach took that fact into account in their behavior. Yet, like *Penn-Olin*, the Court in *Procter & Gamble* did not estimate the price effect that would arise from the elimination of Procter from the fringe.

The Court found a second effect: the acquisition might discourage smaller firms considering entering the market, or already on the fringe. In stating that "[f]ew firms would have the temerity to challenge a firm as solidly entrenched as Clorox," the Court suggested that smaller firms will have even fewer incentives to enter a market dominated by an established incumbent (Clorox) that is owned by a large conglomerate with significant resources (Procter).[93] Thus, the Court reasoned that the transaction would create, or increase, barriers to entry in the bleach market for smaller firms, perhaps significantly limiting the number of perceived potential entrants to only larger firms.

In *Ford Motor Co. v. United States*, the Court again approved an expansive understanding of the concept of potential competition when it did not disturb a district court's findings that Ford Motor Corporation's ("Ford") acquisition of an Autolite spark plug factory in Ohio violated section 7.[94] Prior to the acquisition, Autolite was one of three major spark plug producers.[95] The other two were Champion and General Motors.[96] Together, the three firms represented 85% of the market for spark plugs.[97] The other small firms that made up the balance of the market held "no important share of the market."[98] Ford, the second largest automobile manufacturer, did not produce spark plugs but considered either entering the market on its own or entering through an acquisition.[99] Ford concluded it could manufacture spark plugs itself, but that such an undertaking would consume up to eight years and would be less economical than simply acquiring a firm.[100]

According to the district court's findings, automobile manufacturers were in a unique position with respect to the spark plug market. Their purchases of spark plugs for new cars influenced the replacement spark plug market because mechanics were likely to use the same spark plugs that were originally installed.[101] Thus, Ford had a "pervasive impact on the aftermarket."[102] Automobile manufacturers are also large buyers and could enter the spark plug market themselves, as General Motors

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93. *See id.*
94. 405 U.S. 562 (1972).
95. *See id.* at 566.
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.* at 565–66.
100. *Id.* at 566.
101. *See id.* at 565; *see also id.* at 579 (Stewart, J., concurring).
102. *Id.* at 567.

had done.[103] The district court found Ford's position on the outskirts of the spark plug market to have a "twofold significance. It may someday go in and set the stage for noticeable deconcentration. While it merely stays near the edge, it is a deterrent to current competitors."[104] Thus, the possibility of deconcentrating the market through direct entry and the competitive threat it played on the sidelines were eliminated with the acquisition.

While the Court's review of the case was on the district court's remedy, the Court looked favorably on the outcome, noting that Ford's acquisition altered the market "drastically."[105] With respect to potential competition, the Court noted that the harm was evident because of "the significant procompetitive effects in the concentrated spark plug market that resulted from Ford's position on the edge of the market as a potential entrant."[106]

The cases discussed so far, which stretch through the 1960s and early 1970s, conceptualized the doctrine of potential competition as one where a firm sitting on the sidelines of a market exerted competitive pressure on market participants because the firms that were selling in that particular market took the threat of entry into account. This line of cases developed the doctrine of perceived potential competition. However, firms that are sitting on the sidelines may exert another type of prospective competitive influence on a market. Even if they do not place competitive pressure on market participants now, firms may prospectively compete if they enter the market. While the Court's interpretation of the perceived potential competition doctrine had been expansive, the Court had not addressed this second type of competition, known as the actual potential competition doctrine, until the early 1970s.

The Court first touched on the actual potential competition doctrine in *United States v. Falstaff Brewing Corp.*,[107] while continuing to expand the reach of the perceived potential competition doctrine. Falstaff Brewing Corporation ("Falstaff") was the fourth largest brewer in the country, and the largest brewer that did not have a presence in the New England market.[108] Falstaff publicly expressed great interest in entering the market.[109] Narragansett was a regional brewer that had the largest share of the New England market (20%).[110] The New England market

103. *Id.* at 566–67.
104. *Id.* at 567.
105 *Id.* at 574.
106. *Id.*
107. 410 U.S. 526.
108. *Id.* at 528. The parties stipulated to the geographic market as consisting of Maine, New Hampshire, Vermont, Massachusetts, Connecticut, and Rhode Island. *Id.* at 527 n.3.
109. *Id.* at 529.
110. *Id.* at 528.

was becoming more concentrated.[111] The government alleged that Falstaff's plan to acquire Narragansett violated section 7 because Falstaff was a potential entrant.[112] The government argued that the acquisition "eliminated competition that would have existed had Falstaff entered the market *de novo* or by acquisition and expansion of a smaller firm."[113]

The district court found that Falstaff would not have entered the market "unless it could acquire a brewery with a strong and viable distribution system such as that possessed by Narragansett."[114] Falstaff had considered alternatives short of a merger with a larger firm in New England, including shipping its beer from existing breweries, building a new brewery or acquiring a much smaller brewer in the area.[115] However, the district court found that none of these alternatives would be profitable for Falstaff based on the testimony of the company's executives.[116] The district court found that, because Falstaff never would have entered the market de novo, entry by a merger would not adversely affect competition in the market.[117]

The Court reversed because the lower court "failed to give separate consideration to whether Falstaff was a potential competitor in the sense that it was so positioned on the edge of the market that it exerted beneficial influence on competitive conditions in that market."[118] The Court discounted the testimony of the Falstaff executives on their intentions in favor of "economic facts about Falstaff and the New England market."[119] The Court explained that

> it could not be said on this record that Falstaff's general interest in the New England market was unknown; and if it would appear to rational beer merchants in New England that Falstaff might well build a new brewery to supply the northeastern market then its entry by merger becomes suspect under § 7.[120]

111. *Id.* at 527–28. Four years prior to the merger, the eight largest brewers held 74% of the market; by the time of the merger, they controlled about 81% of the market. *Id.* at 527.

112. *Id.*

113. *Id.* at 529–30.

114. *Id.* at 530.

115. *Id.* at 530–31.

116. *Id.* at 531.

117. *Id.*

118. *Id.* at 532–33.

119. *Id.* at 533–36.

120. *Id.* at 533.

In a subsequent case, the Court described its application in *Falstaff* of these factors as trying to ascertain "if the acquiring firm's premerger presence on the fringe . . . tempered oligopolistic behavior on the part of existing participants in that market."[121]

The Court remanded the case and instructed the district court to apply the perceived potential competition doctrine.[122] It left for another day whether it would recognize an effort to enter a market that was thwarted by an acquisition.[123] The Court noted that there were traces in previous cases that suggested the possibility of such a theory.[124] The Court described the concept as:

> a merger that will leave competition in the marketplace exactly as it was, neither hurt nor helped, and that is challengeable under § 7 only on grounds that the company could, but did not, enter *de novo* or through "toe-hold" acquisition and that there is less competition than there would have been had entry been in such a manner.[125]

The Court more directly addressed this question in *United States v. Marine Bancorporation, Inc.*, but fell short of approving the theory.[126] In *Marine Bancorporation*, National Bank of Commerce, a bank with a large number of branches in the northwest corner of Washington State, planned to acquire Washington Trust Bank, which had branches in the Spokane area in eastern Washington.[127] The district court found that banking services in the Spokane area was a market.[128] This market was concentrated, and Washington Trust Bank had a large market share.[129] But, National Bank of Commerce had admittedly no tangible effect on the Spokane market.[130] Instead, the government argued that National Bank of Commerce could enter the Spokane market in another manner that would be more procompetitive than simply acquiring Washington Trust Bank.[131]

While the Court again skirted whether it would recognize an actual potential competition theory of liability in any case, it did indicate that

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121. *Marine Bancorporation*, 418 U.S. at 624–25.
122. *See Falstaff*, 410 U.S. at 537.
123. *Id.*
124. *Id.*
125. *Id.*
126. 418 U.S. 602.
127. *Id.* at 606–07.
128. *Id.* at 618–19.
129. *Id.* at 607–09.
130. *Id.* at 639–40.
131. *Id.* at 605, 633.

two essential preconditions had to exist.[132] First, the Court found that the acquiring firm must have other feasible means to enter the market, such as an acquisition of a smaller firm.[133] Second, whatever those alternative means of entry are, they must "offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects."[134]

Beyond the government's novel theory, *Marine Bancorporation* was unusual in another way: the case involved an acquisition of a bank—an industry that the State of Washington regulated.[135] Because of this regulatory framework, the Court concluded that National Bank of Commerce could enter the Spokane market only through acquisition.[136] As a result, the Court concluded that the actual potential competitor theory the government raised was inapplicable since it did not satisfy the first essential precondition.[137]

In discussing the possibility of viable claims under the actual potential competition doctrine, the Court in *Marine Bancorporation* spent some time analyzing the perceived potential competition doctrine. The Court explained:

> [i]n developing and applying the [perceived potential competition] doctrine, the Court has recognized that a market extension merger may be unlawful if the target market is substantially concentrated, if the acquiring firm has the characteristics, capabilities, and economic incentive to render it a perceived potential *de novo* entrant, and if the acquiring firm's premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market.[138]

This passage is perhaps the closest the Court came to formulating a direct test for the perceived potential competitor doctrine. While it is clear in some respects, it is less so in others. Apparently, the Court's approach would allow claims where the potential entrant had an ongoing and verifiable influence on the market and the "characteristics, capabilities, and economic incentive" to enter the market, but never had

132. *Id.* at 633.

133. *See id.*

134. *Id.*

135. *See id.* at 609–12.

136. *Id.* at 633. However, Justice White disagreed with the majority, concluding that toehold or de novo entry was a feasible strategy for National Bank of Commerce to pursue even under existing state regulations. *Id.* at 646–47 (White, J., dissenting).

137. *See id.* at 638–39.

138. *Id.* at 624–25.

plans to enter.[139] The Court left somewhat open what characteristics and capabilities a potential entrant needed to prevail on a claim. And, it is unclear how a court should gauge the incentives of the potential entrant. For example, even if entry were profitable in the area where the anticompetitive concern exists, what if entry for the firm were even more profitable in another market altogether?[140]

2. LOWER COURT APPLICATIONS OF THE POTENTIAL COMPETITOR DOCTRINES

The cases discussed above represent the sum of U.S. Supreme Court jurisprudence in this area of law. As this discussion has illuminated, these cases have developed two distinct theories of liability from potential competition. All the cases are fairly specific to their facts and have shed little guidance on the proof necessary to prevail on these theories. It is unsurprising then to find that lower courts have only contributed to the confusion in this area by creating a number of different and conflicting factors to evaluate claims that the acquisition of a potential competitor will violate section 7. Worse still, in some cases, the courts appear to have disregarded what little guidance the Supreme Court has provided them.[141] And, many courts have become very skeptical of such claims entirely.[142]

The courts have often been in conflict with regard to what evidence is necessary to show that a potential competitor is having some impact on the market. The following two cases provide a nice illustration of

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139. *See id.* at 624.

140. Courts have tried to approach this question using an approach that considers more profitable alternatives. The U.S. Court of Appeals for the Fifth Circuit has from time to time examined this issue. *See, e.g.*, Mercantile Tex. Corp. v. Bd. of Governors, 638 F.2d 1255 (5th Cir. Unit A Feb. 1981).

141. For example, the Supreme Court in *Falstaff* had been skeptical of the testimony of the defendant's executives who stated that Falstaff would never enter the New England market. *See* 410 U.S. at 533-36. The Court emphasized the need for an objective test, for example, an examination of the economic facts, to determine whether a firm satisfied the perceived potential competition doctrine. *Id.* at 533; *see also* United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1235-39 (C.D. Cal. 1973). Yet, that did not prevent the U.S. Court of Appeals for the Fourth Circuit from using the testimony of a firm's executives in a case involving the actual potential competition doctrine where the government alleged the firm would enter the copper mining business to justify its result. *See* FTC v. Atl. Richfield Co., 549 F.2d 289, 298 (4th Cir. 1977). The Fourth Circuit concluded that the objective evidence did not "strongly point[] to the feasibility of [de novo] entry." *Id.* Because of the weakness of the objective evidence, the court stated that the "subjective evidence is entitled to some weight." *Id.*

142. One court even rested its denial of a petition for a preliminary injunction in part on the novelty of the perceived potential competition doctrine in 1977—well after the Supreme Court had issued all of its jurisprudence on the topic. *See Atl. Richfield*, 549 F.2d at 293-94.

this conflict. In a case that followed on the heels of many of the Supreme Court's precedents, a district court conducted a fact intensive inquiry to evaluate what the chances of a firm's entry into a market were, but then required little to find that the potential entrant had constrained market behavior.[143] *United States v. Phillips Petroleum Co.* involved Phillips Petroleum Company's ("Phillips") acquisition of the Western Manufacturing and Marketing Division of Tidewater Oil Company ("Tidewater") in 1966.[144] The government alleged a section 7 violation on the basis that Phillips was a perceived and potential entrant into the California gasoline market.[145]

Tidewater was the seventh largest gasoline marketer in California with almost 7% of the market share at the time of acquisition.[146] By 1970, a few years before the suit and after Phillips's acquisition, its share dropped to approximately 5%.[147] Tidewater had refining facilities in California and, prior to the lawsuit, owned or had a leasehold in about 1500 service stations in California.[148] Over the preceding five years, Tidewater's sales of gasoline in California dropped even though demand in California was increasing.[149] The court defined the relevant market as one for motor gasoline in California and it concluded that the market was concentrated.[150] Phillips was not selling gasoline in California, but was the tenth largest gasoline marketer in the country.[151] The court observed that in 1965 the firm had gross sales of $1.46 billion.[152]

The court found entry barriers in the market that would limit the ability of firms to sell gasoline in the state because of the need to build a refinery in the state, or at least somewhere along the West Coast.[153] The court conceded that a refinery was not needed in the short term to enter

143. *Phillips*, 367 F. Supp. 1226.

144. *Id.* at 1228.

145. *Id.* at 1229.

146. *Id.* at 1230.

147. *Id.* at 1248.

148. *Id.* at 1230.

149. *Id.* at 1231. In fact, the court believed that additional service stations in California were viable because of the characteristics of demand in the region. *Id.*

150. *Id.* at 1229, 1252. Seven major oil companies accounted for 81% of gasoline sales and 83% of the refining capacity of the state. *Id.* at 1251–52. The top four firms sold nearly 60% of the gasoline in the state. *Id.* at 1252. The district court failed to discuss the other firms in the market in reaching its conclusion, much less describing the market shares of the larger firms. *Id.* at 1251–52. Interestingly, by later antitrust standards involving potential competition, the market may not be considered very concentrated. *See* ANTITRUST DIVISION, U.S. DEP'T OF JUSTICE, MERGER GUIDELINES § 4.131 (1984) [hereinafter 1984 GUIDELINES]; *see also infra* notes 405–06 and accompanying text.

151. *Phillips*, 367 F. Supp. at 1230, 1239.

152. *Id.* at 1230.

153. *Id.* at 1241, 1254.

the market since "[a] major marketer on the West Coast with no local refining facilities would have to transport product a considerable distance, purchase it on the West Coast, or exchange product elsewhere for product on the West Coast."[154] However, relying on these alternative sources would place a firm at an inherent cost disadvantage.[155] In examining the competitive landscape, very few firms were capable of entering the market.[156]

The district court determined that Phillips was one of those few firms that could enter the market in spite of the fact that it did not have refineries on the West Coast.[157] It relied on four general grounds. First, the court examined Phillips's size, history, and structure.[158] It found that Phillips was large: the firm "was one of the leading domestic oil companies."[159] And, the court ascertained that it "had the financial strength to enter the California motor gasoline market unilaterally."[160] Beyond sheer size, Phillips experienced significant and rapid internal growth in several other retail gasoline markets during the period of 1947 to 1966.[161] And, it found that Phillips had oil exploration interests in the state and in nearby offshore locations.[162] Phillips also sold other plastic products in California.[163]

Second, the district court found that Phillips was intensely interested in entering the California market.[164] The firm was very interested in becoming a national gasoline marketer and explored several options to enter the market.[165] Many of the options short of merger were problematic and even Phillips's attempt for an acquisition of a firm to gain a toehold entry was a failure.[166] The court observed that the negotiations between Tidewater and Phillips perhaps even displayed unequal bargaining power because of the conditions Tidewater extracted.[167]

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154. *Id.* at 1241.
155. *Id.* at 1254.
156. *See id.* at 1242.
157. *Id.* at 1239–42.
158. *Id.*
159. *Id.* at 1239.
160. *Id.* at 1241.
161. *Id.* at 1240. This history of growth by internal expansion extended to its international retail business. *Id.* The district court noted, for example, that Phillips Petroleum Company ("Phillips") had acquired a significant stake in Pacific Petroleums Limited. to "become one of the leading marketers in Canada." *Id.*
162. *Id.* at 1241.
163. *Id.*
164. *Id.* at 1242–45.
165. *Id.* at 1242.
166. *Id.* at 1243–44.
167. *Id.* at 1244–45. The district court observed that "[t]he casualness of the examination of the Tidewater assets by Phillips personnel, and Phillips' willingness to accede to Tidewater's demand that the examination be kept absolutely secret so as not to

Third, Phillips had strong economic incentives to enter the California market.[168] The court emphasized Phillips's ability to expand and become a national marketer of gasoline, which would provide it with efficiencies in advertising and brand loyalty.[169] A national presence would also enable Phillips to better trade crude oil and other products with other firms.[170] Such trading assisted oil firms in coping with regional supply imbalances.[171] Other significant incentives also existed. Phillips's entry provided it with a ready and nearby demand for its Alaskan oil reserves.[172] And, the construction of a refinery in California could increase its petrochemical business in the state—a goal that Phillips's management sought.[173]

Fourth, the court examined the feasibility of unilateral entry into the California market.[174] The court had the benefit of some anecdotal evidence from the successful entry of Humble Oil and Refining ("Humble").[175] Like Phillips, Humble hoped to enter the California market through the acquisition of Tidewater's assets.[176] After the government filed an antitrust suit, Humble withdrew from the transaction and embarked on a $300 million large scale entry effort in 1964 that included the acquisition of retail gasoline outlets and the temporary purchase of alternative gasoline supplies until its own refinery could be constructed.[177] By 1969, an oil refinery was completed and operational in California.[178] By 1970, Humble's share of the California market grew to above 4%.[179] Using the Humble experience, the court found by analogy that Phillips could have entered the market successfully by following a similar strategy.[180]

After finding that Phillips was a potential competitor, the court turned to the question of whether Phillips constrained retail gasoline prices in the California market, or alternatively, would have generated

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impair employee morale, can only be explained by an overwhelming desire for market entry on Phillips' part." *Id.* at 1245.

168. *Id.*
169. *Id.*
170. *Id.*
171. *Id.* at 1246.
172. *Id.*
173. *Id.*
174. *Id.* at 1247–51.
175. *Id.*
176. *Id.* at 1247.
177 *Id.* at 1247–48.
178. *Id.* at 1248.
179. *Id.* Notably, Humble Oil & Refining's market share was still less than what it would have been if it had simply acquired Tidewater Oil Company ("Tidewater"), if the Phillips acquisition history provided any guidance. *See id.* The court recognized this possibility, but stated that it was "speculative," and that its inquiry was focused on the anticompetitive effects of the transaction. *Id.*
180. *Id.* at 1248–51.

significant procompetitive effects from unilateral entry.[181] Thus, the court examined both theories of potential competition and embraced both doctrines in its opinion. On these critical issues, the court relied on a few documents and some conjecture. The court found that competitors' documents, including Tidewater's, demonstrated that Phillips was viewed as a potential entrant into the California market.[182] However, the court did not probe into the magnitude of the effect. Indeed, there was no direct evidence that prices were kept lower because of Phillips's role on the fringe of the market.[183] The court instead set out a presumption that, "[w]hether or not it can be shown that specific actions of companies in the market have been influenced by the presence of the potential entrant on the fringe, it must be assumed that such influence exists where the market is concentrated."[184]

With respect to the benefits of actual entry by Phillips, the court could only offer its belief that a greater number of competitors in the market would be procompetitive since the market was concentrated:

> [a] unilateral entrant would have been an addition to the number of competitors in the concentrated market instead of a mere replacement of an existing competitor, and would have been compelled to seek its place in the market at the expense of established competitors rather than by inheriting a substantial market position.[185]

As the court later explained, while the increase in the number of competitors was a procompetitive benefit in itself, the increase in competitors would spawn greater competition "by the entering firm's struggle to obtain a market share at the expense of the other firms in the market."[186]

Tenneco, Inc. v. FTC reached nearly the opposite result.[187] In *Tenneco*, the Federal Trade Commission (FTC) determined that Tenneco was a perceived potential entrant, among other things, into the market for replacement shock absorbers.[188] Tenneco had acquired the second largest replacement shock absorber manufacturer, Monroe Auto Equipment Company ("Monroe").[189] As the U.S. Court of Appeals for the Second Circuit observed, the replacement market was a highly

181. *Id.* at 1254-57.
182. *Id.* at 1255-56.
183. *Id.* at 1256-57.
184. *Id.* at 1257.
185. *Id.*
186. *Id.*
187. 689 F.2d 346 (2d Cir. 1982).
188. *Id.* at 350.
189. *Id.*

concentrated oligopoly.[190] And, entry could be difficult in the market because of the need to develop scale economies and the need to acquire the technical skill peculiar to the industry.[191] Thus, the FTC required Tenneco to divest the Monroe assets.[192]

The Second Circuit reversed.[193] While it found "abundant evidence" that the market participants perceived Tenneco to be a potential entrant, "the perception of Tenneco as a potential entrant actually temper[ing] the conduct" of the market was not supported by substantial evidence.[194] The Second Circuit found that the market was changing because mass merchandising outlets, such as Sears Roebuck and Company, were selling a growing number of shock absorbers.[195] The court also noted the impact of increased rivalry in the industry from a prior acquisition.[196] In 1962, Maremont acquired Gabriel, a shock absorber manufacturer.[197] Gabriel was the third largest firm in the industry at that time, but its market share had languished.[198] After Maremont's acquisition of Gabriel, the firm undertook significant measures to improve its position and pursued an aggressive cost cutting strategy.[199] By the 1970s, Maremont held the largest market share and increased price competition through its cost-cutting strategy.[200]

The FTC had inferred that this behavior reflected Maremont's efforts to either deter Tenneco from entering the market or to be prepared for rigorous competition.[201] The Second Circuit seized upon this, finding that another explanation probably motivated Gabriel's behavior: its own weakened position in the market during the early 1960s.[202] The only way to improve its position was to compete with the industry leaders, which meant aggressive cost cutting.[203] The court also relied on the testimony of Maremont executives who acknowledged that the firm did not develop its strategy on competitors or potential competitors.[204] The court went further, finding that the FTC failed to meet its burden to present "at least circumstantial evidence that

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190. *Id.* The top four firms accounted for 90% of total sales in 1975 and 1976. *Id.*
191. *Id.*
192. *Id.* at 348.
193. *Id.* at 358.
194. *Id.* at 355.
195. *Id.*
196. *Id.* at 355-56.
197. *Id.* at 356.
198. *Id.*
199. *See id.*
200. *See id.*
201. *Id.* at 356-57.
202. *See id.* at 357.
203. *See id.*
204. *Id.* at 358.

Tenneco's presence probably directly affected competitive activity in the market."[205]

Tenneco approached the question of whether a potential competitor constrains prices in a more exacting manner than the *Phillips* court. The district court judge in *Phillips* assumed that an acknowledged potential entrant exerted some influence over the competitive marketplace even in the absence of specific evidence.[206] The Second Circuit in *Tenneco* required specific proof of action taken by an incumbent in the market in response to its perception that another firm may enter and compete.[207] A vague recognition that other specific firms, such as Tenneco, may enter was not enough.[208] And, actions to cut costs or become more competitive in an industry, without more specific reference to potential competitors, were also insufficient to prevail according to the Second Circuit.[209] These two opposing views are reflected in other cases that discuss the perceived potential competitor doctrine.[210]

Other issues within the perceived potential competition doctrine are clearer. For example, courts have placed importance on the fact that competitors must clearly recognize the firm as a potential entrant.[211] And, courts have looked to more specific attributes of a potential competitor to determine whether its entry would be possible and more likely than others on the fringe, avoiding situations where incumbents could perceive a firm as a potential competitor without an objective basis.[212] However, this approach is somewhat at odds with *Ford Motor*, where the Court found that the threat of entry—even if it was unlikely for some time—was sufficient to find an antitrust violation.[213]

The lower courts have been even more skeptical of the actual potential competition doctrine, probably in large measure because the Supreme Court never explicitly approved it. The U.S. Court of Appeals for the Eighth Circuit is the only appellate court that has accepted the theory while others, like the Second Circuit, have instead elected to

205. *Id.*

206. *See Phillips*, 367 F. Supp. at 1254–57.

207. *See Tenneco*, 689 F.2d at 358.

208. *See id.*

209. *See id.* at 357–58.

210. *Compare* Kennecott Copper Corp. v. FTC, 467 F.2d 67 (10th Cir. 1972), *with* Lektro-Vend Corp. v. Vendo Co., 660 F.2d 255 (7th Cir. 1981), *aff'g* 500 F. Supp. 332 (N.D. Ill. 1980), *and* United States v. Amax, Inc., 402 F. Supp. 956 (D. Conn. 1975).

211. *See, e.g.*, Mo. Portland Cement Co. v. Cargill, Inc., 498 F.2d 851, 863 (2d Cir. 1974); Varney v. Coleman Co., 385 F. Supp. 1337, 1345 (D.N.H. 1974).

212. *See, e.g.*, *Mo. Portland Cement Co.*, 498 F.2d at 863; United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 772 (D. Md. 1976).

213. 405 U.S. at 567–71.

reserve the question of the theory's validity.[214] Moreover, courts have diverged greatly on the fundamental issues regarding proving such claims.

Lower courts have placed varying standards of proof on showing whether a firm would actually enter the market. In *FTC v. Atlantic Richfield Co.*, the U.S. Court of Appeals for the Fourth Circuit, following an article written by Professor Donald F. Turner,[215] suggested that the appropriate standard of proof a plaintiff needed to bring was "clear proof" or even "certain" proof in some cases.[216] The case turned on the question of how likely it was that Atlantic Richfield Company ("Atlantic Richfield"), the acquirer, would likely enter the copper mining, processing, and manufacturing business of the target, the Anaconda Company.[217] The court was doubtful of Atlantic Richfield's entry because of the significant time and expertise necessary to enter the market, which the firm did not have.[218] In contrast, the district court in *Phillips*, which evaluated the Phillips acquisition of Tidewater under the actual potential competition doctrine, asked whether entry was likely.[219] The Second Circuit apparently requires a showing that there was a "reasonable probability" of entry, but prefers "clear proof."[220]

Consistent with the perceived potential competition cases, courts have conducted factually oriented inquiries to determine whether a firm was poised to enter the market. The courts have examined three different kinds of objective evidence: (1) market conditions and trends, (2) the attributes of the alleged potential entrant, and (3) actions that the alleged potential entrant has taken. Each of these general types of evidence essentially attempts to prove the same thing: that the firm would have entered. However, many of these criteria are not definitive and could, in fact, lead to alternative inferences about the competitive effects of a merger.

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214. *Compare* Yamaha Motor Co. v. FTC, 657 F.2d 971, 977-80 (8th Cir. 1981), *with* United States v. Siemens Corp., 621 F.2d 499, 504, 506 (2d Cir. 1980), *and Atl. Richfield*, 549 F.2d at 293-94.

215. Donald F. Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1313 (1965).

216. *Atl. Richfield*, 549 F.2d at 293-95 (emphasis omitted) (quoting Turner, *supra* note 215, at 1384).

217. *See id.* at 292-93.

218. *Id.* at 295-96. The court's level of doubt about these factors seems at odds with *Kennecott Copper*, where the court found that a copper mining firm was likely to enter the coal mining business. 467 F.2d at 76-79.

219. *Phillips*, 367 F. Supp. at 1234.

220. *Siemens*, 621 F.2d at 506-07. The U.S. Court of Appeals for the Second Circuit has also explicitly rejected more lenient standards of proof, such as an "eventual entry" standard, which the Federal Trade Commission (FTC) endorsed in *BOC International Ltd. v. FTC*, 557 F.2d 24, 28-29 (2d Cir. 1977).

When examining market conditions and trends, courts are really trying to determine whether the firm had the appropriate financial incentives to enter the market. Clearly, a growing, profitable market with few market participants is far more attractive for entry than a dying, unprofitable market filled with well-entrenched, hungry rivals.[221] Yet, a growing market often induces other entry that might obviate concerns about potential competition.[222] In *Penn-Olin* and *Phillips*, for example, firms entered the markets of concern—evidently allured by the profits.[223]

The U.S. Court of Appeals for the Fifth Circuit has recommended an opportunity cost approach to determine whether market conditions show that a firm would enter as a witty way to circumvent reliance on other factors.[224] Because a firm's "anticipated profitability" in various markets determines "the direction in which it expands its operations," a court must compare the returns of entry into the market of competitive concern against all other opportunities the firm could pursue.[225] If alternative business opportunities are more profitable than entry into the market of concern, then market conditions suggest that entry is unlikely.[226] When entry is equally profitable among the alternatives, there must be specific evidence "demonstrating why [the firm] might prefer independent entry."[227] Finally, if entry is "markedly" more profitable than the alternatives, the court presumes that the firm would be "a reasonably probable entrant."[228]

While this test seems objective on the surface and offers the possibility of eclipsing other forms of evidence, it is difficult to administer. Projecting the future profitability of one market is difficult enough without estimating the future profitability of other markets. The parties could well conduct something close to a minitrial simply on

221. *See, e.g.*, Grumman Corp. v. LTV Corp., 665 F.2d 10, 14–15 (2d Cir. 1981); *Siemens*, 621 F.2d at 506.

222. One court has viewed a nascent market as a factor that weakens a potential competition claim. *See* Gearhart Indus., Inc. v. Smith Int'l, Inc., 592 F. Supp. 203, 213–14 (N.D. Tex. 1984).

223. In its recitation of the facts, the *Penn-Olin* Court noted that the two incumbent firms in the market nearly doubled their capacity and a new entrant besides the joint venture company began operating in the market. *See* 378 U.S. at 164–65. Finally, outside the market, two other firms entered. *See id.* at 165. In *Phillips*, the district court noted that in the seven years prior to Phillips's acquisition of Tidewater, "five new majors . . . and one large independent . . . entered the market unilaterally or through acquisitions of small companies." 367 F. Supp. at 1252. The district court also conceded that "there has been some degree of deconcentration in the market." *Id.*

224. *See Mercantile Tex.*, 638 F.2d at 1268–69.

225. *See id.* at 1269.

226. *See id.*

227. *Id.*

228. *Id.*

establishing the prospects of entering various alternate markets. Moreover, a court would face many difficult subjective decisions, particularly with regard to how far it should go in evaluating a firm's opportunities. When courts are faced with documents showing that a firm was considering two alternative plans for expansion, such a judicial determination appears to be plausible.[229] However, in the long-run, a firm has the ability to literally remake itself by drastically changing its operations and products. In order to cabin in the alternatives, other factors must be taken into account. For example, entry into a less profitable market could be more desirable because of factors relating to the attributes of the firm. Indeed, in other realms of antitrust law, such as predatory pricing, courts have been skeptical of using the opportunity cost approach.[230]

When examining the attributes of a firm, courts really seem to be trying to determine whether the firm is well suited for entry and whether there are corporate motives, given the firm's overall business strategy, for entry. Thus, courts try to ascertain whether the firm has the expertise,[231] financial wherewithal,[232] previous attempts at entry,[233] and the ability to quickly enter the market while it is still oligopolistic.[234]

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229. *See* United States v. Franklin Elec. Co., 130 F. Supp. 2d 1025, 1033–34 (W.D. Wis. 2000); *see also infra* notes 336–45 and accompanying text.

230. *See, e.g.*, United States v. AMR Corp., 335 F.3d 1109, 1118–19 (10th Cir. 2003); *see also In re* IBM Peripheral EDP Devices Antitrust Litig., 459 F. Supp. 626, 631–32 (N.D. Cal. 1978) (stating that a pricing adjustment based on the "concept of opportunity costs" is "improper as a matter of law" and "was not the intent of the Sherman Act and is not what is meant by predatory pricing"), *aff'd sub nom.* Rebel Oil Co. v. Atl. Richfield Co., 957 F. Supp. 1184, 1202 (D. Nev. 1997). The court in *Rebel Oil* stated:

> It is improper as a matter of law to use opportunity costs to show below cost pricing. Opportunity costs are not reflected in a profit and loss statement, and allowing opportunity costs as a method of cost measure in predatory pricing cases would impermissibly restrict the decision making power of businesses.

957 F. Supp. at 1202 (citations omitted).

231. *See, e.g.*, *Siemens*, 621 F.2d at 507; *Atl. Richfield*, 549 F.2d at 295; *Mo. Portland Cement*, 498 F.2d at 857; Raybestos-Manhattan, Inc. v. Hi-Shear Indus., Inc., 503 F. Supp. 1122, 1134–36 (E.D.N.Y. 1980).

232. *See, e.g.*, *Atl. Richfield*, 549 F.2d at 295; Stanley Works v. FTC, 469 F.2d 498 (2d Cir. 1972).

233. Courts have looked both at attempts at de novo entry or entry through the acquisition of a smaller firm. *See, e.g.*, *Tenneco*, 689 F.2d at 354 (noting that Tenneco failed in negotiations to acquire smaller firms in the market); *Phillips*, 367 F. Supp. at 1244 (noting Phillips's failed attempts at acquiring smaller firms); United States v. Jos. Schlitz Brewing Co., 253 F. Supp. 129, 147–49 (N.D. Cal. 1966) (discussing the firm's failed unilateral attempt to enter the market).

234. *See, e.g.*, Republic of Tex. Corp. v. Bd. of Governors of the Fed. Reserve Sys., 649 F.2d 1026, 1046–47 (5th Cir. Unit A June 1981); *BOC Int'l Ltd.*, 557 F.2d at 29–30 (finding that "eventual entry" that could take "decades" was inadequate to show entry).

Corporate motives for entry relate to a firm's interest in providing a full package of goods, a need to invest excess profits in another business or other efficiencies that may arise from entering the new market that could be passed to other areas of the business in which the firm is presently engaged.[235]

As stated previously, some of these factors seem at odds with showing whether a firm would really enter a market.[236] Failed entry attempts may demonstrate a firm's determination to enter a market or the need to make an acquisition to enter the market. Moreover, a firm that has previously failed to enter a market may obtain sufficient financing to make a subsequent entry attempt more successful than previous attempts.[237] Furthermore, corporate motives can leave courts in a position of second guessing the firm's plans. The firm could have higher priority projects to develop other products. In facing the possibility that a firm may be evaluating entry into other markets, a court may find itself in a position of deciding whether entry into one would be more profitable than entry into the other to determine whether a firm is truly an entrant in the market of concern.

Evaluating the actions a firm has taken also provides perhaps the strongest evidence of entry. Such evidence is weighed on how committed the action makes the firm to entry. Mere statements of interest to enter or equivocal actions are typically not enough to show that a firm is a potential entrant.[238] Clear commitments to enter the market, such as development contracts to build a facility[239] or definitive entry plans, are much more persuasive.[240]

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235. For example, in *Atlantic Richfield*, the Fourth Circuit found that Atlantic Richfield Company had an incentive to enter the copper mining, processing, and manufacturing business because its oil reserves were dwindling. *See* 549 F.2d at 295. In *Siemens*, the firm had incentives to enter the market because it could then offer a full line of medical diagnostic imaging equipment. *See* 621 F.2d at 507; *see also Tenneco*, 689 F.2d at 353.

236. *See supra* p. 31 and notes 21–22.

237. A firm with sufficient capitalization will be able to sustain losses for greater periods of time. Moreover, such a firm will be able to more greatly withstand retaliatory pricing responses. *See, e.g.*, Kevin O'Toole & Carol Shifrin, *JetBlue Takes on Big Apple*, AIRLINE BUS., Aug. 1999, at 14 (noting substantial size of entrant airlines financing).

238. *See BOC Int'l*, 557 F.2d at 29; *Atl. Richfield*, 549 F.2d at 297; *Raybestos-Manhattan*, 503 F. Supp. at 1135.

239. While only a consent decree, the facts lend themselves to a strong case for actual entry in *United States v. Signature Flight Support Corp.* Competitive Impact Statement ¶ C(2), *United States v. Signature Flight Support Corp.*, No. 99-0537, (D.D.C. filed Mar. 15, 1999), *available at* http://www.usdoj.gov/atr/cases/f2200/2297.htm. Another clear example of such entry occurred in *El Paso*; *see* 376 U.S. at 659–60.

240. *See, e.g.*, *Yamaha Motor*, 657 F.2d at 978–79.

Earlier court cases, following the lead of the Supreme Court,[241] also evaluated whether, if a potential entrant needed to enter the market by acquisition, it could have been done so by less anticompetitive means, for example, through the acquisition of a smaller incumbent.[242] This approach seems to mimic other antitrust jurisprudence: when evaluating the reasonableness of contractual restraints between competitors under section 1 of the Sherman Act courts often inquire whether less anticompetitive means could achieve the goal.[243] However, the more recent cases do not seem to follow this approach. Finally, in addition to these types of evidence, courts have at times relied on subjective statements by the firm itself.[244] However, as stated earlier, this kind of evidence is often viewed with some skepticism.[245]

As *Marine Bancorporation* made clear, once the evidence shows that a firm is a potential entrant, a plaintiff must show that the firm's entry would have a significant procompetitive effect on the market.[246] While the Court seemed to suggest that this standard required a more specific showing,[247] the Second Circuit has presumed a procompetitive effect from entry whenever the market is oligopolistic.[248] The Fifth Circuit applies a stricter standard, seeking some evidence that the new entrant would not simply join the existing oligopoly.[249] For example, proof that the firm will gain a market share that will challenge the dominance of other firms and that entry will occur while the market remains oligopolistic could satisfy this standard.[250]

3. *UNITED STATES V. CONTINENTAL CAN CO.*: ANOTHER APPROACH

Many of the decisions discussed thus far represent cases that spanned the 1960s to the early 1980s. After this time, it appears that the potential competition doctrine faded from the antitrust radar screen in spite of the fact that the problems associated with potential competition continued. This submergence of the doctrines occurred in part because

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241. *See Marine Bancorporation*, 418 U.S. at 625; *Falstaff*, 410 U.S. at 537.

242. *See, e.g.*, *Tenneco*, 689 F.2d at 353.

243. *See, e.g.*, NCAA v. Univ. of Okla., 468 U.S. 85, 114–15 (1984); Broad. Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1, 23–24 (1979); Cont'l Airlines, Inc. v. United Airlines, Inc., 277 F.3d 499, 509 (4th Cir. 2002); Augusta News Co. v. Hudson News Co., 269 F.3d 41, 49 (1st Cir. 2001); CDC Techs., Inc. v. IDEXX Labs., Inc., 186 F.3d 74, 80 & n.4 (2d Cir. 1999).

244. *See, e.g.*, *Yamaha Motor*, 657 F.2d at 978–79; *Atl. Richfield*, 549 F.2d at 297–98; *Raybestos-Manhattan*, 503 F. Supp. at 1135.

245. *See supra* note 238 and accompanying text.

246. *See* 418 U.S. at 637–39.

247. *See id.* at 641–42.

248. *See BOC Int'l*, 557 F.2d at 27.

249. *See Mercantile Tex.*, 638 F.2d at 1270.

250. *See id.* at 1271.

another strand of cases dealt with potential competitors in another fashion: the use of expansive concepts of competition within the marketplace.[251] This approach originated in the Supreme Court at the same time it began to develop the potential competition doctrine. Often overlooked, the Court's decision in *United States v. Continental Can Co.*[252] tried to treat an acquisition that involved potential competition largely as a horizontal merger.

Continental Can Company ("Continental Can"), the second largest producer of metal containers, acquired Hazel-Atlas Glass Company ("Hazel-Atlas"), the third largest producer of glass containers in 1956.[253] During this period, container manufacturers were just beginning to diversify and generally made products with one material—metal, glass or plastic.[254] However, producers of each material often competed with one another to provide containers.[255] The district court observed two examples of this form of rivalry.[256] Baby food manufacturers traditionally used metal cans for their products, but efforts by glass makers led to the creation of the baby food jar, which then became the predominant container for the product.[257] Continental Can estimated that 80% of baby food was sold in glass containers, although by 1954 the can industry was beginning to "fight back."[258]

A similar phenomenon took place over containers for soda and beer.[259] While glass had been the predominant material used to hold beer, the metal can industry began a strong effort to encourage brewers to use cans, emphasizing their advantages over glass bottles.[260] As a result, the use of cans became more widespread and both glass and metal container manufacturers were competing to supply brewers.[261]

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251. Professor Phillip Areeda and Professor Herbert Hovenkamp seem to acknowledge this form of attack under section 7 where one firm may be in a "related market." PHILLIP E. AREEDA & HERBERT HOVENKAMP, 3 ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 701e (2d ed. 2002). They state that one firm's technology or experience in one industry "could provide a base for entry." *See id.* They provide three other justifications for precluding mergers between firms in related industries: (1) the related industries may be competing already, (2) firms in the potential entrant's industry may be prejudiced by the merger, and (3) the merger may somehow raise entry barriers. *See id.*

252. 378 U.S. 441 (1964).

253. *Id.* at 443.

254. *Id.* at 444.

255. *Id.* at 448–49.

256. *Id.* at 450–52.

257. *Id.* at 450.

258. *Id.*

259. *Id.* at 451-52.

260. *Id.*

261. *Id.*

The district court found that other less dramatic examples of competition between the different industries existed.[262]

The government sought to break up the acquisition through a divestiture and argued that there was an overall container market that was concentrated enough to warrant a section 7 violation.[263] The district court, while conceding that rivalry existed between glass and metal container manufacturers, concluded that the market, as defined, was too broad, and found that the merger between Continental Can and Hazel-Atlas represented a conglomerate merger with little overlap: it was a merger "'in which one company in two separate industries combined with another in a third industry for the purpose of establishing a diversified line of products.'"[264] Moreover, Hazel-Atlas was not a significant producer of either baby food jars or beer bottles prior to the merger.[265]

The Supreme Court reversed the district court, instead finding that the rivalry between metal and glass container makers could be construed as a market.[266] But, it did so with the implicit understanding that glass container producers and metal container manufacturers were potential competitors.[267] As the Court explained:

> Continental might have concluded that it could effectively insulate itself from competition by acquiring a major firm not presently directing its market acquisition efforts toward the same end uses as Continental, *but possessing the potential to do so.* Two examples will illustrate. Both soft drinks and baby food are currently packed predominantly in glass, but Continental has engaged in vigorous and imaginative promotional activities attempting to overcome consumer preferences for glass and secure a larger share of these two markets for its tin cans. . . . The acquisition of Hazel-Atlas by a company engaged in such intense efforts to effect a diversion of business from glass to metal in both of these lines cannot help but *diminish the likelihood of Hazel-Atlas realizing its potential as a significant competitor in either line.*[268]

The Court dismissed the fact that Hazel-Atlas was not a significant producer for soft drink and baby food manufacturers, emphasizing

262. *Id.* at 452.
263. *See id.* at 447.
264. *Id.* at 448–49 (quoting United States v. Cont'l Can Co., 217 F. Supp. 761, 782 (S.D.N.Y. 1963)).
265. *Id.* at 464–65.
266. *Id.* at 457.
267. *Id.* at 464.
268. *Id.* at 464–65 (emphasis added).

instead that, "with comparatively little difficulty" Hazel-Atlas could have developed baby food jars and soft drink bottles to compete head-to-head with Continental Can.[269] The Court found that in a dynamic market, shifts in focus by container makers acted as a "deterrent against attempts by the dominant members of either industry to reap the possible benefits of their position by raising prices above the competitive level or engaging in other comparable practices."[270]

Continental Can represents another approach toward potential competitors where the potential competitor is described as a competitor within the market because its products could somehow compete in the future.[271] In the case of *Continental Can*, the possibility of competition existed because of possible technological advances in the manufacture of glass containers and the ease to which some competition already existed for certain products, such as for beer and baby food.[272] Some newer cases addressing potential competition have followed this approach.

FTC v. Staples, Inc.[273] represents one modern version of the *Continental Can* approach. In that case, the FTC successfully blocked the planned combination of Office Depot and Staples.[274] The FTC's theory was that so-called office supply superstores constituted a market where there were only three large firms.[275] The geographic markets were metropolitan areas.[276] Relying on both economic data and internal firm memos, the FTC argued that consumer prices were lower in markets where both Office Depot and Staples, or another rival, OfficeMax, competed relative to markets where only one firm serviced the market.[277] While the FTC alleged that a loss of competition from the merger existed in markets where the two firms competed, it also argued that there was a loss of competition in markets where one of the firms planned to enter in competition with the other.[278]

While the focus of the district court's opinion was on the current ongoing competition between Staples and Office Depot, the court used the potential competition issue as a basis for finding an antitrust violation.[279] As the court explained:

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269. *Id.*
270. *Id.*
271. *See id.*
272. *Id.* at 451-52.
273. 970 F. Supp. 1066 (D.D.C. 1997).
274. *Id.* at 1093.
275. *See id.* at 1069, 1073.
276. *Id.* at 1073.
277. *Id.* at 1075-76.
278. *See id.* at 1073. The district court identified at least four areas of potential competition in its opinion. *Id.* at 1073 n.6.
279. *Id.* at 1082, 1093.

> Since prices are significantly lower in markets where Staples and Office Depot compete, eliminating this competition with one another would free the parties to charge higher prices in those markets, especially those in which the combined entity would be the sole office superstore. In addition, allowing the defendants to merge would eliminate significant future competition. Absent the merger, the firms are likely, and in fact have planned, to enter more of each other's markets, leading to a deconcentratation of the market and, therefore, increased competition between the superstores.[280]

Notably, because the parties were already competing in other markets, the court did not analyze the potential competition claims as they were analyzed in other cases, such as *Marine Bancorporation*, *Tenneco* or *Atlantic Richfield*. Of course, the case for potential competition in *Staples* requires a far smaller evidentiary leap given the level of actual competition between the firms as compared to some of the other potential competition cases.

Other types of cases are more closely aligned with *Continental Can* as an alternative to the potential competition cases. Richard Gilbert and Steven Sunshine's analysis of innovation markets is an example.[281] In a nutshell, the feared harm underlying an innovation market case is that two heads are better than one; it is better when two firms innovate independently than combine their research and development effort. The validity of this premise is debatable,[282] and defendants have certainly tried to use the argument to often justify efficiencies from combined research and development.[283] No such case has been fully litigated although there are consent decrees where the government alleged an innovation market.[284]

280. *Id.* at 1082.

281. *See* Richard J. Gilbert & Steven C. Sunshine, *Incorporating Dynamic Efficiency Concerns in Merger Analysis: The Use of Innovation Markets*, 63 ANTITRUST L.J. 569 (1995); *see also supra* note 30 and accompanying text.

282. *See* DENNIS W. CARLTON & ROBERT H. GERTNER, INTELLECTUAL PROPERTY, ANTITRUST AND STRATEGIC BEHAVIOR (Nat'l Bureau of Econ. Research, Working Paper Series No. 8976, 2002), *available at* http://www.nber.org/papers/w8976.

283. *See, e.g.*, FTC v. H.J. Heinz Co., 246 F.3d 708, 722–23 (D.C. Cir. 2001).

284. *See, e.g.*, *In re* Boston Scientific Corp., 119 F.T.C. 549, 549–52 (1995); *In re* Roche Holding, Ltd., 113 F.T.C. 1086, 1086–88 (1990); *see also* Robert J. Hoerner, *Innovation Markets: New Wine in Old Bottles?*, 64 ANTITRUST L.J. 49 (1995) (discussing these as well as other "innovation market" cases); *cf. In re* Gen. Motors Corp., 116 F.T.C. 1276 (1993) (stating that the FTC was eliminating provisions of a 1984 consent decree that limited the ability of General Motors and Toyota to maintain a joint venture because of changed market circumstances, including new entry). The

4. POTENTIAL COMPETITION AS A SHIELD

Courts have recognized the importance of potential competition as a defense to the claim that a particular merger or other action is anticompetitive under an entry analysis.[285] As one court explained, "[i]n the absence of significant [entry] barriers, a company probably cannot maintain supracompetitive pricing for any length of time."[286] However, few cases carefully analyzed potential entrants as a defense to a section 7 claim until the 1990s.[287] And, only the lower courts have decided cases that have dealt with the issue squarely.

Perhaps one of the most significant cases is *United States v. Baker Hughes, Inc.*—authored by Justice Clarence Thomas when he was a circuit court of appeals judge.[288] The government petitioned to block a merger between Tamrock AG ("Tamrock") and Eimco Secoma, S.A. ("Secoma"), a French subsidiary of Baker Hughes.[289] Tamrock and Secoma both produced hard rock hydraulic underground drilling rigs used for oil and gas exploration.[290] The U.S. market for such equipment was fairly small and varied during the period from 1986 to 1988 on which the court focused.[291] Sales were as low as twenty-two units and as high as forty-three during this period.[292] Nonetheless, during this period Tamrock and Secoma sustained a combined average of about 58% of the market.[293] And, in 1988, this figure was 76%.[294] The court concluded that the market share evidence satisfied the government's prima facie burden of establishing a violation.[295]

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original consent decree in *In re General Motors Corp.* was concerned, in part, that the joint venture would eliminate General Motors' incentives to develop smaller cars. *See In re* Gen. Motors Corp., 103 F.T.C. 374, 387 (1984) (statement of Chairman James C. Miller III).

285. In the section 7 setting, *Falstaff* noted the importance of entry. 410 U.S. at 532–33; *see also* United States v. Baker Hughes, Inc., 908 F.2d 981, 987 (D.C. Cir. 1990). Entry has also been discussed in other antitrust settings as well. *See* United States v. Syufy Enters., 903 F.2d 659, 664 (9th Cir. 1990); Ball Mem. Hosp., Inc. v. Mut. Hosp. Ins., Inc., 784 F.2d 1325, 1335–36 (7th Cir. 1986).

286. *Baker Hughes*, 908 F.2d at 987.

287. In the vein of cases like *Staples*, some modern court decisions cast the issue of potential entrants as part of a court's overall analysis of a market rather than an affirmative defense. *See United States v. Oracle Corp.* 331 F. Supp. 2d 1098, 1161 (N.D. Cal. 2004).

288. 908 F.2d 981.

289. *Id.* at 982.

290. *Id.*

291. *Id.* at 986.

292. *Id.*

293. *Id.* at 983 n.3.

294. *Id.*

295. *Id.* at 983.

However, the defendants tried to rebut the market share information by arguing that entry barriers were low enough in the market that the merged firm would be unable to raise prices.[296] The district court agreed with Tamrock and Secoma on four grounds.[297] First, two firms had entered the market in 1989 "and were poised for future expansion."[298] To be sure, there was evidence that two other firms entered the market and failed.[299] But, the district court apparently discounted these failures because it reasoned that a postmerger price increase would make entry more successful in the future.[300]

Second, the court found that a number of foreign firms were potential entrants into the U.S. market.[301] Foreign firm entry into the U.S. was feasible because the market was so small that it would not be particularly costly to develop a sale and service network. Third, the district court noted that the foreign firms would likely exert some competitive pressure on the U.S. market even if none of them did enter. Fourth, the district court noted that the market position of the firms was quite volatile, suggesting that new entrants could make a significant impact on the market.[302] The court observed that Secoma's history proved the point: in 1984, it did not sell one hard rock hydraulic underground drilling rig but, by 1989, it was the market leader.[303]

The government challenged the district court's conclusion on entry barriers because the evidence was insufficient to show that entry would have been "quick and effective" if prices rose as a result of the transaction.[304] The government sought to hold Tamrock and Secoma to a standard where they needed to show that the potential entrants could enter quickly enough to deter any price increase from the merger.[305] The U.S. Court of Appeals for the District of Columbia Circuit rejected the government's position entirely, relying on the cases discussing potential competition.[306]

The court made two very important—and misplaced—observations in this regard. First, it explained:

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296. *See id.* at 987–88.
297. *See id.* at 988–89.
298. *Id.*
299. *Id.* at 989 n.9.
300. *Id.*
301. *Id.* at 989.
302. *Id.*
303. *Id.*
304. *Id.* at 987.
305. *Id.* The government relied on another case where the defendants had shown that entry was "easy" to rebut a section 7 claim. *See* United States v. Waste Mgmt., Inc., 743 F.2d 976, 983 (2d Cir. 1984).
306. *Baker Hughes*, 908 F.2d at 987–88.

> A defendant cannot realistically be expected to prove that new competitors will "quickly" or "effectively" enter unless it produces evidence regarding specific competitors and their plans. Such evidence is rarely available; potential competitors have a strong interest in downplaying the likelihood that they will enter a given market.[307]

This analysis is fascinating because an antitrust plaintiff's standard to show harm from a transaction involving a potential competitor is precisely the standard that the court believed Tamrock and Secoma "cannot realistically be expected to prove."[308] For example, the actual potential competitor doctrine requires a plaintiff to identify one of the merging firms as a potential entrant. As this Article has explained extensively, while courts are in disagreement over the level of proof a plaintiff must show to prove the firm is a potential entrant, it ranges from a showing of a "reasonable probability" to "clear proof," or perhaps even "certainty."[309] Courts have developed several factors to critically assess whether a firm is indeed a potential competitor. Often, the courts search for unequivocal acts on the part of the firm, internal plans or official company statements—the things that "potential competitors have a strong interest in downplaying."[310]

Moreover, under *Marine Bancorporation*, if a plaintiff alleged that a potential entrant was going to enter the market, but for the transaction, then the plaintiff had to show that the firm's entry would have had a significant procompetitive effect on the market.[311] The *Baker Hughes* standard does not impose such a burden on a defendant: as long as firms can conceivably enter the market, the court need not examine whether that entry would occur, much less temper the behavior of the merged firm.[312]

The other important observation the D.C. Circuit made is that the "quick and effective" entry test that the government wanted to place on

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307. *Id.* at 987.

308. *Id.*

309. *See supra* notes 215–20 and accompanying text. Areeda and Hovenkamp have described the *Baker Hughes* decision as one that is "extremely generous to the defendants." PHILLIP E. AREEDA & HERBERT HOVENKAMP, 4 ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 941h (Rev. ed. 1998). It seems clear that Areeda and Hovenkamp believe that a higher evidentiary burden should be placed on defendants in such cases. In criticizing *Baker Hughes*, they state that: "the prophylactic purpose of § 7 is to condemn a merger when it 'may' substantially lessen competition; it does not refuse to condemn mergers that 'may not' substantially lessen competition." *Id.* ¶ 941e.

310. *Baker Hughes*, 908 F.2d at 987; *see also supra* notes 239–40 and accompanying text.

311. *See* 418 U.S. at 632-33.

312. *See* 908 F.2d at 987.

defendants "overlooks the point that a firm that *never* enters a given market can nevertheless exert competitive pressure on that market.[313] If barriers to entry are insignificant, the *threat* of entry can stimulate competition in a concentrated market, regardless of whether entry ever occurs."[314] While this observation is accurate, it again fails to capture the very high burden a plaintiff must meet to prevail on this type of claim in some circuits. Some of the perceived potential competition cases specifically seek evidence that demonstrates that the perceived potential entrant *is* exerting influence on the market. A vague recognition that a firm is a potential competitor was not enough for the plaintiff to prevail in *Tenneco*.[315] Even less evidence was sufficient to mount a defense in *Baker Hughes*.[316]

Some courts have not followed the lenient *Baker Hughes* approach to potential entry as a defense and have more critically examined whether a firm's potential entry can prevent anticompetitive behavior from the merger at issue. *United States v. United Tote, Inc.* provides one example of how some courts have treated the defense more consistently with a plaintiff's burden on the potential competitor doctrine.[317] The case involved the market for totalisator systems, systems designed to support pari-mutuel betting.[318] Totalisator systems control the acceptance of wagers, calculate odds and payouts, cash winning tickets, and provide other functions.[319] Two of the three firms that had been selling totalisator systems planned to merge.[320] The government sought to block the merger based on the high market share of the combined firm and the reduction in the number of competitors from three to two.[321] The government also presented evidence that technical barriers to entry existed.[322] Of five firms that attempted entry during the 1980s, only one succeeded.[323]

United Tote challenged the government's position on market concentration and entry by arguing that other firms were potential entrants in the totalisator market.[324] Relying on *Baker Hughes*, United Tote identified two types of firms that were potential entrants: suppliers of foreign totalisator systems and suppliers of lottery and general

313. *See id.* at 988.
314. *Id.*
315. *See* 689 F.2d at 355; *see also supra* notes 187–210 and accompanying text.
316. *See* 908 F.2d at 987; *see also supra* notes 288–316 and accompanying text.
317. 768 F. Supp. 1064 (D. Del. 1991).
318. *Id.* at 1065.
319. *Id.*
320. *Id.* at 1068–69.
321. *Id.* at 1069.
322. *Id.* at 1072–75.
323. *Id.* at 1076.
324. *Id.* at 1071–72.

transactions-processing systems.[325] Relying on testimony from the firms that were identified as potential entrants, the court found that entry by these firms would be difficult because of the time involved and the need for reliability.[326] The court focused its discussion on International Totalisator Services ("ITS"), a foreign supplier of totalisator systems that was trying to break into the U.S. market.[327] ITS began bidding to provide totalisator systems in North America and began contacting United Tote customers to solicit business.[328] Furthermore, ITS secured two contracts in North America contingent on the required regulatory approval for constructing racing tracks.[329]

In carefully scrutinizing the evidence, however, the district court was skeptical as to ITS's ability to restrain the anticompetitive effects of the merger.[330] The court found that customers were typically concerned about system reliability and preferred to stay with their current supplier.[331] Thus, it was less likely that a racetrack would switch from one totalisator system to another.[332] The reliability issue was especially problematic for a firm like ITS, because it had a "terrible performance record" when it last tried to enter the U.S. market.[333] More generally, it appeared that many entrants failed.[334] The court also found that ITS offered an inferior product and that despite ITS's bids in the market, there was no evidence that an incumbent firm ever adjusted its bid in response to an ITS bid.[335]

United States v. Franklin Electric Co. represents another recent example of a court critically assessing entry as a defense to a section 7 claim.[336] The case was a little unusual in that the defendants raised their potential competition defense as part of a remedy they proposed to ameliorate a merger to monopoly situation.[337] Franklin Electric

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325. *Id.* at 1072, 1080-82.
326. *Id.* at 1080-82.
327. *Id.*
328. *Id.* at 1080.
329. *Id.* at 1081.
330. *Id.* at 1082.
331. *Id.* at 1078.
332. *See id.*
333. *Id.* at 1081.
334. *Id.* at 1077.
335. *Id.* at 1082. The district court found that the ITS product was inferior because it was sold outright rather than leased. *Id.* Totalisator system software was upgraded often and purchasing the equipment forced the racetrack to purchase any software updates. *Id.* at 1081-82. As the court observed, racetracks generally preferred to lease equipment because "they do not want to discover shortly [after purchasing the system] that their equipment has become obsolete." *Id.* The court also found that the acquisition costs to acquire a system were very high, making leasing a preferable option. *Id.*
336. 130 F. Supp. 2d 1025 (W.D. Wis. 2000).
337. *See id.* at 1026.

proposed to establish a technology licensing agreement and supply agreement with Environ, a firm that was not presently in the market.[338] The agreements provided Environ with access to product technology and the right to purchase an important component of the product for at least two years' time.[339] Moreover, there was evidence that Environ had considered entering the market and sold related products to the same customer base.[340]

However, the district court was skeptical of this proposed remedy.[341] The court found that Environ's resources were limited and that it was contemplating entry into another product line that was more financially attractive.[342] Indeed, the court explained that Environ would have few incentives to devote resources to the product because "there is little market interest."[343] Moreover, the court was skeptical of Environ's ability to successfully enter the market because "the company has already devoted several years and undisclosed amounts of money without success" for entry.[344] While the court did not estimate the time for Environ's successful entry into the market, the court suggested that "it would be an extended period of time" that exceeded two years.[345]

Both *United Tote* and *Franklin Electric* represent a more skeptical view of potential competition that is analogous to *Tenneco* and *Atlantic Richfield*.[346] The courts searched more deeply to see whether the potential entrants would constrain a possible price increase from the merged firm. In conducting their analyses, they looked at the same types of factors examined in the potential competition doctrine. The *Franklin Electric* court examined Environ's incentives to enter the market, the likelihood of successful entry, and the timeliness of entry.[347] The district court judge in *United Tote* primarily questioned ITS's ability to successfully enter the market, examining a past failed attempt at entry and customer averseness to switching between totalisator systems.[348] A general examination of past failed entry into the industry appears to be another factor weighing against an entry defense.[349] The *United Tote* court also examined the effect of having ITS on the fringe of the market,

338. *Id.*
339. *Id.*
340. *Id.* at 1030–31.
341. *Id.* at 1033–34.
342. *Id.* at 1033.
343. *Id.*
344. *Id.*
345. *Id.* at 1034.
346. *See supra* notes 317, 336 and accompanying text.
347. *See* 130 F. Supp. 2d at 1033–34.
348. *See* 768 F. Supp. at 1080–82.
349. On this point, see also *Staples*, 970 F. Supp. at 1087.

concluding that there was no impact.[350] Unlike the facts in *El Paso* where the potential entrant, Northwest Pipeline, forced El Paso's bid downward through its unsuccessful bid, totalisator customers were unable to leverage ITS bids in their negotiations with the incumbent totalisator firms.[351]

5. FEDERAL GUIDELINES

The U.S. Department of Justice (DOJ) and the FTC have issued guidelines that discuss how the agencies would apply the concept of potential competition in mergers.[352] While these guidelines are not binding on courts or even the agencies themselves, they are influential.[353] Two sets of guidelines govern the agencies' approach: the *1984 Merger Guidelines* ("the 1984 Guidelines") and the *1992 Horizontal Merger Guidelines* ("the 1992 Guidelines") (collectively "the Guidelines").[354] The Guidelines do not adopt the same approach as the courts have in addressing potential competition. In some cases, the

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350. *See United Tote*, 768 F. Supp. at 1079.

351. *Compare supra* notes 52–59 and accompanying text, *with supra* notes 330–35 and accompanying text.

352. 1984 GUIDELINES, *supra* note 150; U.S. DEP'T OF JUSTICE & FTC, HORIZONTAL MERGER GUIDELINES (1992) [hereinafter 1992 GUIDELINES].

353. Former Assistant Attorney General Charles James recently gave remarks to mark the twentieth anniversary of the *1982 Merger Guidelines*. He likened them to "giant steps" in antitrust enforcement and noted that no other policy document has been as enduring or as far-reaching. *See* Charles A. James, Giant Steps, Remarks at the U.S. Department of Justice on the Occasion of the Twentieth Anniversary of the 1982 Merger Guidelines (June 10, 2002), *available at* http://www.usdoj.gov/atr/hmerger/11253.pdf.

Courts have cited the *1984 Merger Guidelines* ("the 1984 Guidelines") and the *1992 Horizontal Merger Guidelines* ("the 1992 Guidelines") (collectively "the Guidelines") numerous times. For example, many courts have relied on various propositions in the 1992 Guidelines to reach their decisions. *See, e.g.*, C.F. Indus., Inc. v. Surface Transp. Bd., 255 F.3d 816, 823 n.13 (D.C. Cir. 2001); *H.J. Heinz*, 246 F.3d at 716 & n.9, 718, 720–22 & 721 n.20; AlliedSignal, Inc. v. B.F. Goodrich Co., 183 F.3d 568, 574 n.3 (7th Cir. 1999); United States v. Eastman Kodak Co., 63 F.3d 95, 106 (2d Cir. 1995); Olin Corp. v. FTC, 986 F.2d 1295, 1299–1300 (9th Cir. 1993); United States v. Visa U.S.A., Inc., 163 F. Supp. 2d 322, 335–39 (S.D.N.Y. 2001); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 45–49 (D.D.C. 1998); *Staples*, 970 F. Supp. at 1081–82; HTI Health Servs., Inc. v. Quorum Health Group, Inc., 960 F. Supp. 1104, 1112 n.4, 1127, 1133 n.27 (S.D. Miss. 1997); State v. Kraft Gen. Foods, Inc., 926 F. Supp. 321, 352, 359–60 & 359 n.9, 365 (S.D.N.Y. 1995); Bon-Ton Stores, Inc. v. May Dep't Stores Co., 881 F. Supp. 860, 871–72 & 871 n.6, 875–76 (W.D.N.Y. 1994).

354. 1984 GUIDELINES, *supra* note 150; 1992 GUIDELINES, *supra* note 352. In most respects, the 1992 Guidelines replaced the 1984 Guidelines issued by the DOJ. 1992 GUIDELINES, *supra* note 352, § 0 n.4. The Merger Guidelines are periodically revised "as necessary to reflect any significant changes in enforcement policy or to clarify aspects of existing policy." *Id.* For purposes of our discussion, we do not opine on whether the revised guidelines reflected a significant change in enforcement policy.

Guidelines co-opt potential competitors as actual competitors, while in others it treats them as potential competitors under a different framework.

As we explain below, the Guidelines can be read together. To the extent the 1992 Guidelines discuss potential competition concepts, they define some firms that courts traditionally viewed as on the sidelines of a market, that is, firms that are not currently producing the relevant product, to be in the market. Thus, under the 1992 Guidelines, some firms that are potential entrants under the potential competition doctrine are actual competitors.

The 1992 Guidelines also refer to the 1984 Guidelines as an authority on "non-horizontal" mergers.[355] The 1984 Guidelines address circumstances where the 1992 Guidelines have not identified certain firms as actual competitors. As the 1992 Guidelines suggest, the 1984 Guidelines take a similar approach to the vast majority of Supreme Court cases in the field; the 1984 Guidelines treat mergers involving potential entrants as non-horizontal mergers.[356] Thus, the two sets of guidelines view firms that courts have described on the sidelines differently: the 1992 Guidelines may find firms that fit under the potential competition doctrine to be actual competitors and the 1984 Guidelines may find firms that fall within the ambit of the potential competition doctrine to be potential competitors.

We begin with the 1992 Guidelines as a starting point. The 1992 Guidelines identify firms that are relevant to an antitrust assessment of a transaction.[357] The Guidelines are neutral in identifying such firms.[358] By placing a firm that would satisfy the criteria of the potential competition doctrine in a market, an incumbent's acquisition of a potential entrant could raise competitive concerns. Alternatively, the

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355. In affirmative cases asserting the potential competitor doctrine, the 1984 Guidelines remain in force. As the DOJ and FTC explained upon the release of the 1992 Guidelines: "guidance on non-horizontal mergers is provided in Section 4 of the Department's *1984 Merger Guidelines*, read in the context of today's revisions to the treatment of horizontal mergers." U.S. DEP'T OF JUSTICE & FTC, STATEMENT ACCOMPANYING RELEASE OF REVISED MERGER GUIDELINES (Apr. 2, 1992), *reprinted in* ABA ANTITRUST SECTION, THE 1992 HORIZONTAL MERGER GUIDELINES: COMMENTARY AND TEXT 21, 22 (1992) [hereinafter DOJ & FTC STATEMENT].

356. Section 4 of the 1984 Guidelines states that "non-horizontal mergers involve firms that do not operate in the same market." 1984 GUIDELINES, *supra* note 150, § 4.0. In discussing potential competition in section 4.11, the 1984 Guidelines explain: "[i]n some circumstances, the non-horizontal merger of a firm *already in a market* (the acquired firm) with a *potential entrant to that market* (the acquiring firm) may adversely affect competition in the market." *Id.* § 4.11 (emphasis added) (footnotes omitted).

357. 1992 GUIDELINES, *supra* note 352, § 1.31-.32.

358. *See id.*

existence of potential competitors could assuage any competitive concern from an acquisition.[359]

In defining the participants of a market, the 1992 Guidelines note that "firms not currently producing or selling" in the market will be included in that market if "inclusion would more accurately reflect probable supply responses."[360] The 1992 Guidelines set out three conditions for such firms to be included in the market: (1) the firm can produce the product within one year; (2) without incurring "the expenditure of significant sunk costs of entry and exit"; and (3) "in response to a 'small but significant and nontransitory' price increase."[361] Sunk costs are the "acquisition costs" of assets that cannot be redeployed to another use once they are committed to the market.[362] The 1992 Guidelines call firms that meet this three-part test "uncommitted entrants."[363] However, a firm is not an uncommitted entrant if, while technically capable of entering the market, the firm will not because it is ultimately unprofitable.[364] Such firms "will not be considered to be . . . market participant[s]" at all.[365]

Still other firms may be considered for their "competitive significance" even where entry takes longer than a year and significant sunk costs are required.[366] The standard for such firms is a different three-prong test that the 1992 Guidelines employ in an entry analysis. If entry is timely, likely, and sufficient, then a merger is unlikely to create competitive concerns.[367] Timeliness of entry is defined as "within two years from initial planning to significant market impact."[368] The two-year rule may be extended in some circumstances.[369] For example, when consumers can defer purchases for a longer period of time to accommodate future entry, the two-year rule is relaxed.[370] Entry "is likely if it would be profitable at premerger prices, and if such prices

359. *See id.* § 3.0.

360. *Id.* § 1.32.

361. *Id.*

362. *Id.*

363. *Id.*

364. *Id.* Difficulty in gaining product acceptance or difficulties in achieving adequate distribution or production are examples that may cause entry to be unprofitable. *Id.*

365. *Id.*

366. *Id.* The language of the 1992 Guidelines is interesting in that it does not necessarily suggest that such firms are in the market.

367. *Id.* § 3.2–.4.

368. *Id.* § 3.2.

369. *Id.*

370. *Id.* For example, the 1992 Guidelines discuss a scenario in a market involving durable goods where consumers can invest in extending the life of the product for a period beyond two years. *Id.* If entry can occur during the extended life of the product, entry is timely under the 1992 Guidelines. *Id.*

could be secured by the entrant."[371] The "sufficient" prong of the entry analysis in the 1992 Guidelines refers to other qualitative factors that affect how the entrant may compete beyond the mere likelihood of entering the market.[372] The 1992 Guidelines note, for example, that entry is not sufficient when "the tangible and intangible assets required for entry are not adequately available for entrants to respond fully to their sales opportunities."[373] The 1992 Guidelines do not identify such firms as "in" the market, although they have competitive significance.[374]

The 1992 Guidelines do not cover the full range of cases that courts have identified under the potential competition doctrine. The 1984 Guidelines, issued only by the DOJ, address some of these special cases where the potential competition doctrine has identified a firm as relevant to an antitrust analysis. Like the potential competition doctrine, the 1984 Guidelines apply only to a plaintiff's case.[375] The 1984 Guidelines recognize that a merger "of a firm already in a market . . . with a potential entrant to that market . . . may adversely affect competition in that market."[376] The 1984 Guidelines accept both variants of the potential competition doctrine: perceived potential competition and actual potential competition.[377] The 1984 Guidelines also recognize the possible anticompetitive effects from acquisitions of, or by, potential entrants.[378]

The 1984 Guidelines dismiss the narrower view of section 7 that rejects the actual potential competition doctrine. The narrow view reasons that since section 7 requires a plaintiff to show a substantial "lessening of competition" as a result of a transaction, competition is not diminished when a firm acquires a potential entrant who was not presently constraining prices in the market.[379] The 1984 Guidelines describe the effects of actual potential competition as ones where "the merger could result in a lost opportunity for improvement in market performance resulting from the addition of a significant competitor."[380] And, the 1984 Guidelines further explain:

371. *Id.*

372. *See id.* § 3.4.

373. *Id.*

374. *See id.*

375. *See* 1984 GUIDELINES, *supra* note 150, § 4.0.

376. *Id.* § 4.11.

377. *Id.* § 4.111-.112.

378. *See id.*

379. Professor Donald F. Turner noted this argument as one dating into the late 1950s, but rejected it as well. Turner, *supra* note 215, at 1379-80 (citing James A. Rahl, *Applicability of the Clayton Act to Potential Competition*, 12 A.B.A. SEC. ANTITRUST L. 128, 143 (1958)).

380. 1984 GUIDELINES, *supra* note 150, § 4.112.

> If it were always profit-maximizing for incumbent firms to set price in such a way that all entry was deterred and if information and coordination were sufficient to implement this strategy, harm to perceived potential competition would be the only competitive problem to address. In practice, however, actual potential competition has independent importance. Firms already in the market may not find it optimal to set price low enough to deter all entry; moreover, those firms may misjudge the entry advantages of a particular firm and, therefore, the price necessary to deter its entry.[381]

In contrast to the court's treatment of the potential competition doctrine, the 1984 Guidelines provide three simplified standards for merger review.[382] According to the 1984 Guidelines, the market of incumbent firms must be concentrated, entry into the market must not be "generally easy," and the potential entrant must be uniquely advantaged to enter the market.[383] The 1984 Guidelines also provide objective benchmarks for the first two criteria.

With respect to market concentration, the DOJ and FTC ("the Agencies") use the Herfindahl-Hirschman Index ("HHI") to estimate the concentration of a particular market.[384] Unless market concentration exceeds 1800, it is "unlikely" the Agencies will challenge the transaction.[385]

The 1984 Guidelines also provide some analysis on the relevance of the market shares of committed competitors when the acquirer is a potential entrant. If the potential competitor enters the market through the acquisition of an incumbent on the fringe of the market, a challenge to the transaction is unlikely because "[s]mall firms frequently play peripheral roles in collusive interactions, and the particular [entry] advantages of the acquiring firm may convert a fringe firm into a significant factor in the market."[386] Thus, toehold acquisitions of firms commanding 5% or less of the market are unlikely to receive scrutiny, while acquisitions of firms holding 20% or more are likely to face greater scrutiny.[387]

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381. *Id.* § 4.12

382. *Id.* § 4.131-.133

383. *Id.*

384. *See id.* § 4.131. The Herfindahl-Hirschman Index ("HHI") is calculated for the market by summing the squares of each firm's market share in a defined market. By squaring the market shares, the HHI weights firms with larger market shares, but still includes all market participants in estimating the overall concentration of the market.

385. *Id.*

386. *Id.* § 4.134.

387. *Id.*

The entry inquiry is also measured by fairly objective criteria. When entry into a market is "generally easy" antitrust enforcers are less likely to challenge an acquisition of or by a potential entrant even if entry is "marginally easier" for that firm.[388] As the ease of entry increases, incumbent firms are less likely to raise their price in response to an acquisition involving potential entrants because other firms could easily become producers in the market if prices rose modestly.

The final remaining criterion the 1984 Guidelines call for—entry advantage—remains somewhat nebulous. The 1984 Guidelines state a challenge to a transaction is "unlikely . . . if the entry advantage ascribed to the acquiring firm . . . is also possessed by three or more other firms."[389] This safe harbor is not effective, however, when "strong" evidence demonstrates that actual entry was likely by the potential entrant.[390] Some commentators have criticized the ambiguity of the 1984 Guidelines on this point.[391] Notably, the 1984 Guidelines fail to describe what constitutes an entry advantage at all, much less with reference to other uncommitted firms.

Under the Clinton Administration, both Agencies filed cases in transactions where potential competition issues arose. While one commentator has criticized the Agencies for not pursuing these issues aggressively enough,[392] the Agencies brought claims that often resulted in consent decrees.[393] In many of these cases, federal antitrust enforcers have relied on the 1992 Guidelines approach and identified firms as actual competitors in an antitrust market. The enforcement actions plead a broad market and examine potential competition issues as part of a broader claim of actual, ongoing competition between firms.[394]

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388. *Id.* § 4.132.

389. *Id.* § 4.133.

390. *Id.*

391. HOVENKAMP, *supra* note 3, § 13.5; Joseph F. Brodley, *Potential Competition Under the Merger Guidelines*, 71 CAL. L. REV. 376, 389–401 (1983). While written prior to the 1984 Guidelines, Brodley's criticisms were not addressed in the 1984 Guidelines. *Id.*

392. *See* John E. Kwoka, *Non-Incumbent Competition: Mergers Involving Constraining and Prospective Competitors*, 52 CASE W. RES. L. REV. 173, 174 (2001).

393. *See, e.g.*, United States v. Signature Flight Support Corp., 1999-2 Trade Cas. (CCH) ¶ 72,611 (D.D.C. July 30, 1999); Am. Compl. ¶¶ 37–39, United States v. Northwest Airlines Corp., No. 98-74611 (M.D. Fla. filed Dec. 18, 1998), *available at* http://www.usdoj.gov/atr/cases/f2100/2158.htm; *Staples*, 970 F. Supp. 1066; New York *ex rel.* Abrams v. Primestar Partners, L.P., 1993-2 Trade Cas. (CCH) ¶ 70,403 (S.D.N.Y. Sept. 14, 1993); Zeneca Group PLC, No. C-3880 (June 7, 1999), *available at* http://www.ftc.gov/os/1999/06/zenecacomp.htm; *In re* Hoechst AG, 120 F.T.C. 1010 (1995); *Boston Scientific*, 119 F.T.C. 549; *see also* SULLIVAN & GRIMES, *supra* note 26, § 11.3a.

394. *See supra* notes 273–80 and accompanying text (discussing *Staples*, 970 F. Supp. 1066); *see also Signature Flight Support*, 1999-2 Trade Cas. at 85,512–14;

For example, in *United States v. Northwest Airlines Corp.*, the government sought to have Northwest Airlines ("Northwest") divest its stock holdings in Continental Airlines ("Continental").[395] Northwest held a majority of Continental voting stock but placed it in a voting trust subject to certain restrictions.[396] The airlines also entered into a system-wide joint marketing arrangement as part of an alliance agreement.[397] The government alleged that because of Northwest's majority stake in Continental, Northwest and Continental would not compete on certain routes where they presently competed.[398] The government was particularly concerned about certain hub-to-hub routes, where each airline operated a hub at either end of the routing.[399] In addition to the routes that each airline already flew, the government was also concerned that the transaction would "diminish the potential for nonstop competition for Memphis-Cleveland and Memphis-Newark, as well as potential competition in other markets for which Northwest and Continental are among the few likely future providers of scheduled airline passenger service."[400]

This discussion of the Guidelines has emphasized the criteria required to satisfy a potential competition claim from the perspective of a plaintiff. However, the 1992 Guidelines also address the concept of potential competition from the standpoint of demonstrating that a merger of two incumbents should not be challenged because potential entrants exist. The 1992 Guidelines state:

> A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels. Such entry likely will deter an anticompetitive merger in its incipiency, or deter or counteract the competitive effects of concern.[401]

As we have discussed, uncommitted entrants are included in the market even though they are not presently providing goods or services in the market.[402] And, firms that are not uncommitted entrants may still be

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Compl. ¶¶ 32-36, *Northwest Airlines*, No. 98-74611 (E.D. Mich. filed Oct. 23, 1998), *available at* http://www.usdoj.gov/atr/cases/f2000/2023.htm.

395. Compl., *Northwest Airlines*, *supra* note 394, at 1.
396. *Id.* ¶¶ 15-16.
397. *Id.* ¶ 18.
398. *Id.* ¶¶ 32-33.
399. *Id.* ¶ 33.
400. Am. Compl., *Northwest Airlines*, *supra* note 393, ¶ 38.
401. 1992 GUIDELINES, *supra* note 352, § 3.0.
402. *See supra* notes 360–63 and accompanying text.

considered a competitive force, thereby negating the effects of an otherwise anticompetitive transaction, if they meet the three criteria for entry in the 1992 Guidelines discussed above—timely, likely, and sufficient entry.[403]

The Guidelines offer a menu of three possible tests to identify firms relevant to an antitrust analysis that courts have traditionally identified using the potential competition doctrine.[404] The 1992 Guidelines may treat a firm as an actual competitor under one test and then consider a firm's "competitive significance" under a separate entry analysis. The 1984 Guidelines may identify a firm as a potential competitor that is relevant to an antitrust review under a separate test.

The 1984 Guidelines test, to determine whether a transaction involving a potential competitor rises to an antitrust violation, appears to be more onerous for antitrust plaintiffs than the 1992 Guidelines treatment of actual competitors. A higher threshold exists under the 1984 Guidelines to use potential competitors in an affirmative case. The HHI must be 1800 before an acquisition of a potential entrant raises competitive concerns.[405] In the 1992 Guidelines, an antitrust problem may arise in mergers that result in a postmerger HHI between 1000 and 1800.[406] However, this difference may not be as significant as it seems because the Agencies rarely oppose mergers where the HHI is below 1800.

Furthermore, the 1984 Guidelines contain a safe harbor provision that provides better protection for merging parties. The safe harbor provision generally permits a merger between a firm that is a potential competitor and a firm that is an incumbent when three potential entrants with an entry advantage are identified.[407] The 1992 Guidelines do not provide a similar safe harbor provision when two incumbents merge in a market and the parties are able to demonstrate that three uncommitted entrants or other possible entrants exist.

Therefore, the Guidelines treat what they identify as potential competitors as less significant than actual competitors. For example, consider a market with two actual competitors and four firms that would not be considered actual competitors under the 1992 Guidelines, but potential competitors under the 1984 Guidelines. The safe harbor would not apply to a transaction between the actual competitors, but would apply to a transaction between one actual competitor and one potential competitor. But, it is possible that the potential competitor could have greater antitrust significance in the market than an incumbent. One

403. *See supra* notes 366–74 and accompanying text.
404. *See* 1992 GUIDELINES, *supra* note 352, § 3.0.
405. 1984 GUIDELINES, *supra* note 150, § 3.11.
406. 1992 GUIDELINES, *supra* note 352, § 1.51.
407. 1984 GUIDELINES, *supra* note 150, § 4.133.

incumbent could have a small market share while one of the potential entrants, who may take a longer time to enter the market, could revolutionize it. One could imagine such a scenario in a nascent industry.

In addition, the Guidelines treat the same general concept—the identification of firms that are not currently producing in a market, but which are competitively significant from an antitrust perspective—with different criteria. For example, a firm that does not meet the criteria for being an uncommitted entrant may still be competitively significant if it meets the three-prong entry test in the 1992 Guidelines—although it may not get assigned a market share.[408] However, the entry test may be relaxed. For example, the 1992 Guidelines extend the two-year limit in its entry test in special circumstances.[409] Thus, a firm that does not meet the three-prong entry test may still be competitively significant under the 1992 Guidelines.

However, the 1992 Guidelines fail to discuss the exceptions to the two-year rule beyond providing one example. The authors believe that an exception should exist for firms that have planned entry farther into the future in some cases. We also recommend that another exception should exist with respect to the nature of investments in an industry. Often, the time required to enter the market is significantly longer in industries with high fixed costs. Those firms may be the only firms poised to enter the market if anyone is to enter at all. On a similar note, in an affirmative case to determine whether such a firm that is a party to a merger is competitively significant, it will flunk the uncommitted competitor test of the 1992 Guidelines, leaving the more onerous test of the 1984 Guidelines as the benchmark for whether an antitrust violation exists.

In addition, the 1992 Guidelines have difficulty in assessing the impact of a firm that fits within the description of: (a) an uncommitted entrant or (b) a competitively significant firm that is not producing the relevant product currently and is not an uncommitted entrant. The 1992 Guidelines market share analysis determines whether a merger may raise competitive concerns, but there may not be enough information to measure the importance of these firms, particularly if the firms have no existing capacity to produce the product. The Guidelines may resolve this issue by not assigning market shares at all or by calculating market shares by using the "best indicator of firms' future competitive significance"—whatever that may mean.[410]

Defendants using the Guidelines' approach face similar difficulties. Suppose that the defendants identify firms that do not meet the 1992

408. 1992 GUIDELINES, *supra* note 352, § 3.2-.4.

409. *Id.* § 3.2.

410. *See id.* § 1.41.

Guidelines' three tests discussed above to identify firms in the market, but would satisfy the 1984 Guidelines' definition of a firm that is a competitively significant potential competitor for purposes of an antitrust review.[411] In a merger involving incumbents, the 1984 Guidelines' safe harbor provision could not be used by the parties to argue that the merger has no anticompetitive effects, and it is unclear how the identified potential competitors would be weighed in analyzing the merger. Neither set of guidelines really addresses this situation.

The language of the tests set out in the 1984 Guidelines and the 1992 Guidelines also creates some confusion with respect to how the different tests should be interpreted.[412] The 1984 Guidelines and the 1992 Guidelines both deal with entry in terms of their analysis of mergers. The 1992 Guidelines set specific standards for entry, including a time frame for entry and an evaluation of the likelihood and effect of actual entry.[413] These standards may be relevant to identifying competitively significant firms that are not identified as actual competitors or as uncommitted entrants. As part of determining whether a firm is a potential competitor for purposes of determining an antitrust violation, the 1984 Guidelines require entry to be difficult—or at least generally not easy.[414] Yet, whether the 1992 Guidelines analysis of entry barriers is high enough for the 1984 Guidelines is unclear. Similarly, the entry advantage prong of the 1984 Guidelines test for potential competitors is not explained well and the 1992 Guidelines entry analysis does not explain its relationship to the 1984 Guidelines entry advantage concept.[415]

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411. For example, imagine a firm that has a pending patent application for a manufacturing process that it seeks approval of before it will embark on constructing a plant to manufacture a product. Factoring in construction time and the necessary governmental approvals, entry may take as long as five years. Besides the incumbents in the market, the firm is the only one with a pending patent application, making it uniquely positioned to enter the market relative to other firms on the sidelines. This firm might satisfy the 1984 Guidelines test for a competitively significant potential entrant, but probably not any of the 1992 Guidelines tests.

A defendant probably need not satisfy all the criteria of potential competitors as set out in the hypothetical firm above. For example, if the HHI is lower than 1800, this should not limit a defendant's ability to identify a firm with an entry advantage as relevant to a market.

412. Our discussion of the 1992 Guidelines is not intended to be a comprehensive critique. Sullivan and Grimes have noted other criticisms of the 1992 Guidelines. *See, e.g.*, SULLIVAN & GRIMES, *supra* note 26, §§ 10.2a, 11.2e.

413. *See* 1992 GUIDELINES, *supra* note 352, § 3.2–.4.

414. *See* 1984 GUIDELINES, *supra* note 150, § 3.3.

415. According to Dr. Gregory Werden of the DOJ's Economic Analysis Group, the enforcement agencies may impute the 1992 Guidelines standards of entry to the 1984 Guidelines. Telephone Interview with Dr. Gregory Werden, Senior Economic Counsel, Economic Analysis Group, U.S. Dep't of Justice (June 10, 2003).

Other cases of potential competition may not fit well under any of the tests set out in the Guidelines. For example, firms that are unlikely to produce a product may still constrain prices. Incumbents, having imperfect information, may misperceive which firms are potential entrants. The firm on the sidelines in one market may find it unprofitable to enter, at least in the short run, but may have an incentive to spread misinformation, especially if it competes with the incumbents in other markets and is perceived as a logical entrant in the market. The sideline firm's incentive in such a case might be to have incumbents price competitively in the market in which it is not present in order to reduce the revenues the incumbents could use to compete against it in the market where the firms are all currently producing a product. Such a firm flunks the standards to be an actual competitor, uncommitted entrant or otherwise competitively significant firm under the 1992 Guidelines because it is not profitable to enter in response to a postmerger price hike. And, if a firm is unlikely to enter a market, it probably does not have an entry advantage as required by the 1984 Guidelines. Yet, consumers may be harmed from a merger of an incumbent and our hypothetical hesitant entrant.[416]

C. Section 1 of the Sherman Act

As we have noted, under section 1 of the Sherman Act, potential competition is discussed as part of a court's entry analysis. We now turn to that analysis and first examine section 1 per se cases that involve

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416. The Guidelines may have difficulty handling other scenarios as well. A firm's management may not be committed to entering the market, even if it would be profitable and entry would be easy for it, thus satisfying the likelihood of entry prong of the test. Moreover, quite rational reasons might exist for a firm to elect not to enter the market, such as more profitable ventures in other markets. Other subjective factors may similarly exist to thwart entry; the firm's management philosophy may be decidedly against future entry for some reason, such as a past failed entry attempt in another market.

There is a weak argument that the 1992 Guidelines address such scenarios by noting as an initial matter on entry that "[a] merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels." 1992 GUIDELINES, *supra* note 352, § 3.0. "Likely" could be read not to mean the likelihood prong of the entry test, but as something different: namely, that the chances of an event are probable. The Guidelines, however, do not really elaborate on this interpretation beyond this sentence, and in every other respect when the Guidelines discuss likelihood of entry, they focus on the profitability of a firm to enter the market. For example, section 3 discusses the likelihood criterion as an "assess[ment of] whether committed entry would be a profitable and, hence, a likely response." *Id.* Furthermore, the Guidelines do not acknowledge a fourth criterion which evaluates the subjective intent or philosophy of the firm.

various restraints. The next two sections discuss the section 1 cases that examine joint ventures and the federal antitrust guidelines that analyze joint ventures.

1. PER SE RESTRAINTS CASES

The Supreme Court has had little to say on the subject of potential competition in the realm of section 1, except to caution against its overuse. In *United States v. Topco Associates, Inc.*,[417] the Court was confronted with a government action against a cooperative association of independent regional supermarket chains operating in thirty-three states.[418] Topco Associates, Incorporated ("Topco") was the member supermarket's purchasing agent, procuring more than 1000 different items, most of which have brand names owned by Topco.[419] The supermarkets owned equal proportions of Topco's voting stock, chose its directors and completely controlled the association's operations.[420] Topco's bylaws established exclusive territorial licenses for its members, precluding member supermarkets from selling Topco-brand products outside of the supermarket's exclusive territory.[421]

The government charged that this territorial market scheme violated section 1.[422] Topco contended that it needed the territorial restrictions to "maintain its private-label program" and foster interbrand competition between it and larger market chains.[423] The district court agreed, and upheld the restrictive practices as reasonable and procompetitive.[424]

The Supreme Court reversed.[425] The Court noted that, "[t]heoretically, all manufacturers, distributors, merchants, sellers, and buyers could be considered as potential competitors of each other."[426] The Court did not address at all whether the supermarkets were potential competitors, given that the agreement's purpose was to limit competition among them.[427] Beyond the Court's cryptic observation, it has left the entry question in the hands of the lower courts.

The U.S. Court of Appeals for the First Circuit's decision in *Engine Specialties, Inc. v. Bombardier, Ltd.*,[428] represents a relatively

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417. 405 U.S. 596 (1972).
418. *Id.* at 597–98.
419. *Id.* at 598.
420. *Id.* at 598–99.
421. *Id.* at 602.
422. *Id.* at 603.
423. *Id.* at 604–05.
424. *Id.* at 605–06.
425. *Id.* at 612.
426. *Id.* at 606.
427. *See id.* at 610–11.
428. 605 F.2d 1 (1st Cir. 1979).

straightforward application of entry analysis to section 1. Engine Specialties ("ES") and Agrati-Garelli ("Agrati") entered into an agreement providing that ES would be the sole distributor for Agrati minicycles in North America.[429] Bombardier Limited ("Bombardier"), then the largest manufacturer of snowmobiles, had developed a prototype minibike called the "Fun-Doo."[430] However, Bombardier decided that the Fun-Doo would not perform well in the marketplace, and met with Agrati to discuss various proposals for the distribution and manufacture of minicycles.[431] Agrati contacted ES about the possibility of relinquishing its exclusive deal.[432] Agrati also suggested that Bombardier could award ES a bike dealership and invest in ES.[433] ES rejected these suggestions.[434]

Nevertheless, Bombardier and Agrati formed a joint venture that would manufacture and possibly sell motorcycles.[435] Agrati terminated its relationship with ES, claiming that ES had breached its contract.[436] ES's supply line was effectively severed.[437] ES filed a section 1 claim and alleged that the joint venture was a per se violation.[438] The matter was submitted to a jury.[439] Among other things, the jury was asked to determine whether "Bombardier was a potential competitor" of Agrati and whether it had the "intent and ability to market cycles like the Fun-Doo of its own manufacture."[440] The jury answered this question in the affirmative and Bombardier appealed, based in part on the application of the per se rule to its arrangement with Agrati.[441] Bombardier argued that the per se rule had never been applied to an agreement between two companies not yet in competition with one another.[442]

The First Circuit concluded that there was "adequate record support for the jury's finding that Agrati and Bombardier were potential competitors at the manufacturing level.[443] This evidence included: (1) Bombardier stipulated that it *could* produce all parts necessary for a motorcycle; (2) Bombardier's president testified that the firm decided

429. *Id.* at 3.
430. *Id.*
431. *Id.*
432. *Id.* at 4.
433. *Id.*
434. *Id.*
435. *Id.*
436. *Id.* However, there was no provision in the contract that required Engine Specialties ("ES") to open any lines of credit. *Id.*
437. *Id.* at 6.
438. *Id.* at 2.
439. *Id.* at 6 & n.7.
440. *Id.* at 6 n.7.
441. *Id.* at 6–7 & 6 n.7.
442. *Id.* at 7.
443. *Id.* at 10.

not to manufacture its own minicycle because of the joint venture; (3) Bombardier had "developed, manufactured, and tested" its Fun-Doo minicycle; (4) Bombardier's president told the board of directors that the Fun-Doo would be available on the market; (5) a Bombardier engineer testified that Bombardier had the manufacturing capacity necessary to enter the minicycle market; (6) Bombardier had drafted a "production and sale schedule for the Fun-Doo"; and (7) Bombardier threatened Agrati with entry if they could not reach an agreement.[444]

The First Circuit did not indicate which of the foregoing facts were dispositive. Instead, the court viewed them in light of the jury's finding that Bombardier was a potential competitor.[445] In doing so, it identified two elements necessary to demonstrate that a firm is a potential entrant: "requisite intent and ability to enter the minicycle market on its own."[446] However, it is not clear whether Bombardier had either. While Bombardier had adequate manufacturing capacity, the product was of inferior quality. Instead of entering de novo, Bombardier chose to use its product as a credible threat against Agrati. The fact that the Fun-Doo was a credible threat may indicate that entry was technically feasible, but not necessarily economically viable. Unfortunately, *Bombardier* does little to clarify when entry is viable and when it is not.

The Fifth Circuit fared no better in articulating a standard five years later in *Transource International, Inc. v. Trinity Industries, Inc.*[447] Trinity Industries Incorporated ("Trinity") and Transource International Incorporated ("Transource") executed an agreement under which Transource agreed to assign purchase orders for railcar components to Trinity.[448] Transource agreed to secure an initial order for the purchase of 250 railcars and to assign the order to Trinity.[449] In exchange, Trinity agreed to loan $20,000 in working capital to Transource for eight months.[450] Finally, Transource agreed to include a noncompetition clause in the contract that prohibited it from competing with Trinity in

444. *Id.* at 9–10.

445. *Id.* at 9.

446. *Id.* at 10. Having found that Bombardier Limited ("Bombardier") and Agrati-Garelli ("Agrati") each operated on the same manufacturing level, the Court then proceeded to examine the agreement between the two companies for evidence of per se violations. *Id.* It discovered several requirements in the agreement that foreclosed Agrati from selling or manufacturing certain types of motorcycles within North America. *Id.* at 10–11. Bombardier was similarly barred from selling or manufacturing certain types of motorcycles outside of North America, meaning that under the agreement, "Bombardier is free of Agrati's competition in both sales and manufacturing in North America and Agrati is free of Bombardier's competition in manufacturing outside of North America." *Id.*

447. 725 F.2d 274 (5th Cir. 1984).

448. *Id.* at 277.

449. *Id.* at 277–78.

450. *Id.* at 278.

the marketing and manufacturing of railcars during the term of the agreement.[451] Transource failed to complete the necessary financial arrangements and, potentially in breach of contract, petitioned the court to have the agreement declared void as a per se section 1 violation.[452] As in *Bombardier*, a key issue in the case was whether Transource was truly a potential competitor to Trinity.

While the parties negotiated a noncompete clause into their agreement, the court concluded that Transource was not a potential competitor.[453] Transource was in poor financial condition.[454] Transource only had $1000 in assets and it conceded that, without the agreement with Trinity, it "could not exist as a viable economic entity."[455] Furthermore, Transource's principals had attempted to enter the railcar manufacturing business on a previous occasion and failed.[456]

However, the Fifth Circuit's reliance on the failed entry attempt is at odds with other cases discussing potential competition. The *Transource* court concluded that prior failed attempts to enter a market, in addition to other factors, demonstrate an inability to enter.[457] In contrast, other cases conclude that failed attempts are evidence of impending successful entry.[458] A paucity of assets similarly may or may not be significant: investment bankers may provide capital depending on their expectations of success. An inability to find investors, of course, would lead to the conclusion that the court reached here.

Potential competition can also be used to show that multiple violations of the antitrust laws are in fact a single violation. The significance of finding multiple violations is readily apparent: it exposes defendants to greater liability. The U.S. Court of Appeals for the Third Circuit confronted this application of potential competition in *United States v. Sargent Electric Co.*[459] A grand jury returned an indictment against defendants Sargent Electric Company ("Sargent") and Lord Electric Company ("Lord") charging a violation of section 1 of the Sherman Act by "conspiring to rig bids for electrical construction work at the Fairless Hills Works of United States Steel Corporation in Bucks County, Pennsylvania."[460] Defendants moved to dismiss the indictment,

451. *Id.*

452. *Id.* at 278–79 (noting that Transource International Incorporated ("Transource") also raised Sherman Act section 2, Clayton Act section 3, state antitrust law, and contract law claims).

453. *Id.* at 280.

454. *Id.*

455. *Id.*

456. *Id.*

457. 725 F.2d at 280.

458. *See, e.g.*, *infra* notes 479–520 and accompanying text.

459. 785 F.2d 1123 (3d Cir. 1986).

460. *Id.* at 1124.

charging that the indictment was identical to the one under which they had been convicted and thus violated the double jeopardy clause.[461] The previous indictment had charged defendants with "conspir[ing] to rig bids for electrical construction work at the Western Pennsylvania Works of U.S. Steel."[462] The court was thus confronted with the issue of whether coconspirators rigging bids for various projects could be indicted for each bid rigged or whether such a succession of indictments would violate double jeopardy.[463] In making this determination, the crucial question was whether the defendants operated in several relevant markets.[464] If so, the coconspirators could be charged with multiple section 1 violations despite having an objective common to all the relevant markets.

While the court noted that typically a horizontal agreement defines the relevant market,

> [w]here, as here . . . the disputed issue is the existence or scope of the alleged horizontal agreement that is to be inferred from circumstantial evidence, the first inquiry must be whether or not each firm alleged to have been a party to it was an actual or potential competitor in that market.[465]

The court concluded that multiple section 1 violations could be charged because the lists of authorized bidders changed for each victim of the conspiracy, and thus, the individuals involved in each conspiracy (and thus the relevant market) differed to some degree:

> Given the incongruity in membership of the approved bidder lists and the fact that those lists were controlled by the management of the separate facilities, it is not surprising that, as the court found, "Only the contractors on the bid list for that project would attend the [bid-rigging] meeting. If a contractor was not on the bid list for a particular project, the contractor would not even be informed that a meeting was to take place."[466]

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461. *Id.*

462. *Id.* at 1125.

463. *See id.* at 1124–25. The coconspirators had already been convicted of rigging bids for electrical work at the Western Pennsylvania Works of U.S. Steel when they received an indictment charging them with rigging bids for electrical construction work at the Fairless Hills Works of U.S. Steel. *Id.* at 1125.

464. *See id.* at 1126–30.

465. *Id.* at 1127.

466. *Id.* at 1129 (alteration in original) (quoting United States v. Sargent Electric Co., No. 84-00313, at 6 (E.D. Pa. Mar. 26, 1985)).

The court rebuffed the district court's notion that there was the potential for competition between sellers not on the approved list and those on the approved list (and therefore, a single violation of the Sherman Act).[467] Thus, the attempt by Sargent and Lord to quash the indictment was foiled because of the inability of potential competitors to enter the distinct markets that were subject to rigged bids. Had the competitors been overlapping, then the markets would have been identical and double jeopardy would have attached.

The inability of a firm to enter a market has been used successfully by defendants to demonstrate that no per se violation of section 1 was possible. In *TechniCAL, Inc. v. Allpax Products, Inc.*,[468] TechniCAL Incorporated ("TechniCAL") filed an action seeking relief from a settlement agreement that provided in part that "'[TechniCAL] agrees to stay out of the new retort[469] market in North America for the term of the license [agreement between Allpax and TechniCAL].'"[470] Allpax Products Incorporated ("Allpax") unsurprisingly, manufactured new retorts and TechniCAL decided it wanted to enter the business.[471] TechniCAL argued that the restriction was a horizontal market division—a per se violation of section 1.[472] The district court rejected TechniCAL's argument.[473] The court stated that "at the time the parties settled this action, TechniCAL did not participate in the manufacturing, selling, or marketing of new retorts either directly or indirectly through third parties. Moreover, TechniCAL did not have any intention of doing so."[474] The district court found that TechniCAL was traditionally a consultant for the food sterilization industry[475] and was a "vertical competitor[]" with Allpax.[476]

Unfortunately, the court's analysis is conclusory and several questions remain. First, the court does not specify why there would be a provision that prohibited TechniCAL from entering the retort market if there was no anticipation that TechniCAL would ever enter that market. Such an interpretation would render the clause meaningless and without value. Also, while the court observes that TechniCAL was not a current entrant and mentions the underlying basis for that conclusion, it does not elaborate why TechniCAL had no intent to enter the retort market.

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467. *Id.* at 1129–30.

468. 786 F. Supp. 581 (E.D. La. 1992).

469. A retort is a "large vessel[] used by the food processing industry to . . . sterilize multiple [food] containers." *Id.* at 583 n.1.

470. *Id.* at 583 & n.4.

471. *Id.* at 583, 586.

472. *Id.* at 586.

473. *Id.*

474. *Id.*

475. *Id.* at 586 n.12.

476. *Id.* at 586.

Moreover, the district court failed to address whether TechniCAL had the ability to enter the retort market. If TechniCAL had the ability to enter, the agreement might have served to raise prices by guaranteeing to Allpax that TechniCAL would not enter the market.

2. JOINT VENTURES

In the absence of certain conduct, such as price fixing or horizontal divisions of markets, a joint venture is most likely subject to the rule of reason analysis under section 1. In rule of reason cases, the role of potential competition in the analysis of the joint venture is reversed from per se cases; defendants are likely to argue that potential competitors are on the periphery, ready to discipline prices if the joint venture becomes too greedy. The plaintiff, conversely, is likely to argue that no such entry exists, and even if it does exist, it will not occur in a timely manner and will not be sufficient to discipline attempts to raise prices above their competitive levels. And, because joint ventures may also be analyzed under section 7 of the Clayton Act, potential competition analysis more closely reflects the underlying foundations of the potential competition doctrine found in section 7 than the analysis found in per se section 1 cases.[477]

Regrettably, the joint venture cases are vulnerable to the same vices as the section 7 cases that apply the potential competition doctrine. The doctrine is unspecific and may lead to faulty conclusions. And, some have argued that a section 7-style application of the potential competitor doctrine to joint ventures tends to ignore the procompetitive benefits that might accompany a joint venture while overestimating the harms.[478]

The Eighth Circuit's review of Yamaha Motor Company's ("Yamaha") joint venture with Brunswick Corporation ("Brunswick") to produce and sell outboard motors provides a nice illustration of how

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477. *See supra* Part II.B.1.

478. It is not clear that joint ventures should have the same standard applied to them as is applied to mergers. *See* Joseph Kattan, *Antitrust Analysis of Technology Joint Ventures: Allocative Efficiency and the Rewards of Innovation*, 61 ANTITRUST L.J. 937, 959 (1993) (noting that a merger causes the cessation of all competition, while a joint venture only precludes competition in the areas covered by the joint venture agreement); *see also* Thomas A. Piraino, Jr., *Beyond Per Se, Rule of Reason or Merger Analysis: A New Antitrust Standard for Joint Ventures*, 76 MINN. L. REV. 1, 13–14 (1991). As Thomas A. Piraino, Jr. noted:

> Merger analysis requires a complicated assessment of the relevant product and geographic markets, each of the parties' shares of those markets, their competitors' market shares, and any increase in market concentration that will result from the transaction. These determinations are fact intensive and time consuming, and their outcome is difficult to predict.

Piraino, *supra*, at 13–14 (footnote omitted).

courts apply the potential competition doctrine.[479] Brunswick held between 19.8% and 22.6% of the outboard motor market.[480] Before entering the joint venture, Brunswick was considering developing a second line of outboard motors in order to increase market share within the United States.[481]

Prior to the joint venture, Yamaha had entered the outboard motor business by acquiring a 60% interest in Sanshin Kogyo Company ("Sanshin") and sold the outboard motors under the Yamaha name throughout the world, but not in the United States.[482] Yamaha had made two previous failed attempts to enter the U.S. market.[483] Yamaha's first attempt involved the introduction of a low-horsepower, one-cylinder, air-cooled engine that failed because U.S. consumers preferred the less expensive, two-cylinder, water-cooled engines already available.[484] Yamaha then attempted to sell engines through Sears Roebuck and Company, but the engine still proved too costly for U.S. consumers.[485]

Brunswick and Yamaha agreed to enter a joint venture.[486] The agreement called for Brunswick to acquire a 38% share in Sanshin, Yamaha's outboard motor division.[487] Yamaha's share would drop to a level equal to Brunswick's share.[488] The entire output of Sanshin's production was to be sold to Yamaha.[489] Yamaha would keep some of the motors for sale under the Yamaha brand name, while the remainder would be sold to Brunswick for sale under its brand name, Mariner.[490]

The joint venture agreement contained numerous collateral agreements.[491] Brunswick had exclusive rights to sell the Sanshin motors in the United States, Canada, certain regions of Mexico, Australia, and New Zealand.[492] Yamaha had exclusive rights to sell the Sanshin motors in Japan.[493] Yamaha agreed not to manufacture or resell the Sanshin engines or any similar models.[494] Brunswick was prohibited

479. *Yamaha Motor*, 657 F.2d 971.
480. *Id.* at 973. Market share was measured by unit volume. *Id.*
481. *Id.*
482. *Id.* at 974.
483. *Id.* at 978-79.
484. *Id.*
485. *Id.*
486. *Id.* at 974.
487. *Id.*
488. *Id.*
489. *Id.*
490. *Id.* The motors were physically identical. *Id.*
491. *Id.*
492. *Id.*
493. *Id.*
494. *Id.*

from manufacturing any products competitive with Yamaha products, except snowmobiles.[495]

The court determined the relevant market to be the outboard motor market (subdivided into low and high horsepower) in the United States.[496] Within these confines, the top four firms accounted for 94.9% of the U.S. market in terms of units sold, and the top two firms controlled 72.9%.[497] The industry, the Eighth Circuit noted, was becoming more concentrated, with three of the eight competitors in the market exiting in the four previous years.[498]

The FTC filed a complaint claiming that the joint venture violated section 7 of the Clayton Act and section 5 of the Federal Trade Commission Act.[499] An administrative law judge reviewed the action and issued an initial decision, stating that, while "Yamaha was a likely potential unilateral entrant into the United States high horsepower outboard market," the joint venture was, on balance, procompetitive: "the main objective fact in this case . . . is that the joint venture added to the relevant market a new procompetitive force—the Mariner line of outboard motors."[500] In other words, the joint venture enhanced competition in the outboard motor market. The administrative law judge also found that Yamaha "was not considering entering [this market] on its own in the near future and had no concrete plan to do so."[501] The FTC reviewed the decision and reversed, finding that Yamaha was both an actual and potential competitor of Brunswick and that three collateral agreements relating to the joint venture were unlawful.[502] The Eighth Circuit upheld the FTC's decision.[503] In affirming, the court analyzed Yamaha's position as an actual potential entrant.[504] It applied the *Marine Bancorporation* two-step analysis, finding that Yamaha "had

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495. *Id.*

496. *Id.*

497. *Id.* Market shares by dollar volume were 98.6% and 85%, respectively. *Id.*

498. *Id.*

499. *Id.* at 975; *see also* 15 U.S.C. § 45 (allows the FTC to prevent and restrain unfair methods of competition). Unfair methods of competition have traditionally included violations of the Sherman Act and the Clayton Act.

500. *Yamaha Motor*, 657 F.2d at 975 (omission in original) (internal quotations omitted).

501. *Id.* (internal quotations omitted).

502. *Id.* Specifically, the FTC found to be anticompetitive: (1) the provisions precluding Yamaha from marketing the joint venture output in North America and Brunswick from doing the same in Japan; (2) the provisions precluding Brunswick from producing products competitive with Yamaha products, with the exception of snowmobiles; and (3) the provisions that barred Brunswick from inviting Yamaha dealers into "non-exclusive markets" where Brunswick and Yamaha were allowed under the agreement to compete freely with one another. *Id.*

503. *Id.* at 973.

504. *Id.* at 977–79.

'available feasible means' for entering the relevant market, and . . . 'that those means offer[ed] a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive benefits.'"[505]

With respect to the first factor, the court found that Yamaha would have entered the U.S. market de novo but for the joint venture.[506] The court based this argument on the fact that the U.S. market is an attractive, large, and sophisticated market.[507] Moreover, the court noted that Yamaha had been selling substantial numbers of outboard motors outside the United States, implying that Yamaha could therefore make sales had it entered the U.S. market.[508] Moreover, the court noted Yamaha's extensive experience in marketing outboard motors in other areas of the world.[509] Yamaha also had the technology needed to be a viable entrant, including a "'complete line' of models with a wide horsepower range suitable for entry into the United States market."[510] The court also found that Yamaha had a viable opportunity to market its wares in the United States, despite lacking a network of dealers.[511] Finally, the court found that Yamaha had the subjective intent to enter.[512] Specifically, the court noted that Yamaha's two unsuccessful attempts at entry combined with its ambitious program of expanding its product line were aimed at the U.S. consumer.[513]

With respect to the second factor of the *Marine Bancorporation* test, the court simply noted that, in an oligopolistic market, five firms in competition are better than four.[514] Moreover, the court emphasized the prominence of Yamaha's brand name in the United States and Yamaha's considerable financial strength.[515] Preserving the procompetitive benefit of an addition to the number of competitors in the engine market from Yamaha's impending de novo entry outweighed any efficiency justification for the joint venture.[516]

The *Yamaha* decision raises several issues. As a preliminary matter, if Yamaha were a potential entrant into the U.S. market, were there other firms outside the United States whose potential for entry

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505. *Yamaha Motor*, 657 F.2d at 977-78 (final alteration in original) (quoting *Marine Bancorporation*, 418 U.S. at 633).

506. *Id.* at 978.

507. *Id.*

508. *Id.*

509. *Id.*

510. *Id.*

511. *Id.*

512. *Id.*

513. *Id.* at 978-79.

514. *Id.* at 979. "Any new entrant of Yamaha's stature would have had an obvious procompetitive effect leading to some deconcentration." *Id.*

515. *Id.*

516. *Id.*

would have a disciplining effect on price?[517] If so, then the market may have been significantly less concentrated than the Eighth Circuit believed.[518] Furthermore, the evidence that the court points to in concluding that Yamaha would have entered the U.S. market generally begs the question of whether Yamaha would really enter. For example, the court gushes at Yamaha's success outside the United States.[519] Yet, given Yamaha's past failures in the United States, the court reasons that Yamaha is likely to enter the U.S. market de novo.[520] However, that evidence equally leads to the opposite conclusion: Yamaha's two botched forays into the U.S. market proves that it could not successfully enter *without* a joint venture. Yamaha's prior failures in the United States do not portend well for long-term competition in the market.

Plaintiffs have also used potential competition in a defensive mode to show that entry is unlikely to discipline the market. In *United States v. Ivaco, Inc.*, the government filed a complaint to block a proposed joint venture between Ivaco Incorporated ("Ivaco") and Jackson Jordan, Incorporated ("Jackson Jordan").[521] The joint venture proposed to combine the automatic tamper businesses of Jackson Jordan and Ivaco, as well as the railway maintenance of way businesses of the two companies.[522] The complaint alleged that the joint venture would violate section 7 of the Clayton Act by creating a company that would control over 70% of the automatic tampers sold in the United States, and that entry into the market was difficult.[523] The government sought a preliminary injunction to prevent the venture from forming before litigation took place.[524]

The district court ruled that the proposed joint venture between Ivaco and Jackson Jordan would probably lessen competition and issued an injunction.[525] The court noted that the market for automatic tampers appeared to be shrinking.[526] Moreover, because the current participants

517. J. Fred Weston & Stanley I. Ornstein, *Efficiency Considerations in Joint Ventures*, 53 ANTITRUST L.J. 85, 89 (1984).

518. *See* Avarelle Silver, *A New Standard for Evaluating Conglomerate Joint Ventures Under Clayton Act Section 7 and a New Formula for the Potential-Competition Doctrine*, 33 HASTINGS L.J. 1441, 1456 (1982) (noting that the court of appeals relied almost exclusively on evidence that the U.S. market was highly concentrated in its potential competition analysis); Weston & Ornstein, *supra* note 517, at 89.

519. *See Yamaha Motor*, 657 F.2d at 977–79.

520. *Id.* at 978–79.

521. 704 F. Supp. 1409, 1411 (W.D. Mich. 1989).

522. *Id.* at 1411–12. Tampers are machines that "place ballast underneath a railroad track tie in order to level and shift the tie." *Id.* at 1412.

523. *Id.* at 1411, 1419–20. The HHI presented by the antitrust division for automatic tampers was 3549 preventure and 5809 postventure. *Id.* at 1419.

524. *Id.* at 1411.

525. *Id.* at 1430.

526. *Id.* at 1413.

in the market could satisfy market demand and because of the enormous capital investment involved in such entry, the court concluded that entry into the market was nonsensical and therefore "the threat of entry by new firms would not pose a significant constraint on price increases in the market for these machines."[527]

It is strange that the fact that the tamper market was shrinking did not weigh in favor of the defendants. If the market were shrinking, one would expect some level of consolidation. Moreover, the court did not specify the degree to which current suppliers could meet demand. For example, if supply was abundant because of excess capacity, some reduction of that capacity due to the joint venture might be efficient and not anticompetitive.

3. THE FEDERAL JOINT VENTURE GUIDELINES

In addition to the various cases describing, and perhaps misapplying, the potential competition doctrine in joint ventures, the DOJ and FTC published the Antitrust Guidelines for Collaborations Among Competitors ("AGCAC"), which also discuss potential competition.[528] The AGCAC, like the 1992 Guidelines, are not binding upon courts or the Agencies. The AGCAC apply to joint ventures.[529] The AGCAC recognize both per se and rule of reason approaches, depending on the conduct at issue.[530] The AGCAC's analysis under the rule of reason to a large degree is similar to the 1992 Guidelines, including issues such as the ease of entry.[531]

However, one important distinction between the Agencies' merger analysis and their analysis in the AGCAC exists. While a merger means the total elimination of competition between the two parties, it is not necessarily true that, under a joint venture between two competitors, competition will cease. The AGCAC explicitly recognize this remnant of competition.[532] One central feature of this approach is whether the

527. *Id.* at 1420.

528. AGCAC, *supra* note 30. The AGCAC were issued in April of 2000 to "assist businesses in assessing whether the Agencies will challenge a competitor collaboration or any of the agreements of which it is comprised." *Id.* § 1.1.

529. *Id.* § 1.3.

530. *Id.* § 3.2-.3. For example, the AGCAC apply the two approaches to agreements to allocate markets, bid rigging or price fixing, *id.* § 3.2, and to agreements to restrict output, *id.* § 3.3.

531. The DOJ and FTC (collectively "the Agencies") examine the nature of the agreement, including purpose and any harm to competition, market definition, shares and concentration, the parties' ability and incentive to compete, the ease of entry; and if competitive harm is likely, whether the restraint is necessary to provide overriding procompetitive benefits. *Id.*

532. *Id.* § 3.34. The AGCAC state: "[i]n general, competitive concern likely is reduced to the extent that participants actually have continued to compete, either through

joint venture firms continue to have incentives to compete against each other.[533]

In addition to the traditional means by which potential entry is analyzed under the 1992 Guidelines, the AGCAC add a facet of subjective evidence to its analysis. The AGCAC examine the perceptions of potential entrants toward the joint venture and their likely responses.[534] The AGCAC assert that entry is influenced by how the potential entrants perceive the joint venture's terms.[535] For example, as the AGCAC point out,

> [T]he likelihood of entry may be affected by what potential entrants believe about the probable duration of an anticompetitive agreement. Other things being equal, the shorter the anticipated duration of an anticompetitive agreement, the smaller the profit opportunities for potential entrants, and the lower the likelihood that it will induce committed entry.[536]

D. Section 2 of the Sherman Act

Cases falling within the reaches of section 2 of the Sherman Act generally refer to anticompetitive conduct of a monopolist or would-be monopolist. These monopolization and attempted monopolization cases sometimes confront the issue of whether a potential competitor is "in the market." Specifically, a potential competitor may be the victim of a monopolist's efforts to deter it from entering or it may be the potential competitor that keeps a monopolist in check and dissuades it from raising prices, stifling innovation, and restricting output. In many cases, the issues are raised within the context of deregulating industries.

The *Otter Tail Power Co. v. United States*[537] case represents an instance where a potential competitor was the target of conduct purported to be unlawful under the antitrust laws. The government

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separate, independent business operations or through membership in other collaborations, or are permitted to do so." *Id.* § 3.34(a).

533. *See id.* § 3.34. Specifically, factors that determine whether the collaboration leaves room for competition among the participants include: whether the collaboration is exclusive; whether the collaboration leaves the participants with control over a significant portion of their existing assets; each participant's financial interests in the collaboration or other participants; the degree to which the participants control the collaboration's decision making processes; the likelihood of anticompetitive information sharing; and the duration of the collaboration. *See id.* § 3.34(a)–(f).

534. *Id.* § 3.35.

535. *Id.*

536. *Id.*

537. Otter Tail Power Co. v. United States, 410 U.S. 366 (1973).

brought a civil antitrust action against Otter Tail Power Company ("Otter Tail"), the only retail electric power provider in 465 towns in Minnesota, North Dakota, and South Dakota.[538] The government claimed that Otter Tail's refusal to sell or "wheel" power to municipal electrical systems in its territory was a violation of section 2 of the Sherman Act.[539] It also used its contracts with other wholesale power suppliers to discourage them from supplying the municipalities.[540] Finally, the government claimed that Otter Tail used litigation to delay establishment of municipal electric systems.[541] The government argued that this conduct violated section 2.[542]

The DOJ viewed the municipalities as Otter Tail's potential competitors for the provision of retail electricity service within their municipal boundaries.[543] In retail electricity markets, competition is solely between an incumbent utility and a potential entrant; either the municipality or the utility serves the end users.[544] If a municipal electric system is established, the incumbent utility is foreclosed (perhaps forever) from serving those customers on a retail basis.[545] Because of the risk of losing its business altogether, Otter Tail argued that its actions to foreclose municipalities from establishing electric systems were necessary to the utility's survival.[546] As more municipalities established electric systems, Otter Tail would "go downhill."[547]

The Court rejected Otter Tail's argument, noting that the "[u]se of monopoly power to destroy threatened competition is a violation of . . . § 2 of the Sherman Act."[548] The Court did not explain with much detail why the municipality was a potential competitor. Clearly, Otter Tail had monopoly power,[549] and the conduct is consistent with a section 2 violation. However, the Court could not delve into whether the municipalities were realistic competitors to Otter Tail. Otter Tail controlled the municipalities' destiny because it controlled the access to electricity. Otter Tail prevented the municipalities from obtaining power[550] and even employed litigation to "delay[] and prevent[] the

538. *Id.* at 368.
539. *Id.*
540. *Id.*
541. *Id.*
542. *Id.*
543. *See id.* at 377–81.
544. *Id.* at 378.
545. *See id.*
546. *Id.* at 380.
547. *Id.*
548. *Id.* at 377 (internal quotations omitted).
549. *See* United States v. Otter Tail Power Co., 331 F. Supp. 54, 59 (D. Minn. 1971) (finding that Otter Tail held 75.6% of the relevant market).
550. *Id.* at 61.

establishment of municipal electric systems."[551] Thus, evidence of the ability of the municipality to enter the market, as is examined in other potential competition claims, is not particularly helpful.

A potential competitor may be simultaneously the target of monopolizing conduct and the monopolist's defense, excuse or justification for its conduct. The DOJ's most recent antitrust litigation against Microsoft illustrates this issue.[552]

The government brought a monopolization, attempted monopolization, and tying case against Microsoft.[553] In particular, the government was concerned about Microsoft's combination of its web browser[554] and operating system[555] for the purpose of eliminating Netscape, then the major producer of web browsers, from the browser market.[556] The government alleged that Netscape was a threat to Microsoft's operating system dominance because the web browser would allow consumers to access programs from the Internet without the

551. *Otter Tail*, 410 U.S. at 379. Generally, the initiation of litigation is insufficient to support a Sherman Act claim. *See* United Mine Workers v. Pennington, 381 U.S. 657, 669–70 (1965); E.R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127, 135-36 (1961). The initiation of litigation can in part be a violation of the Sherman Act where "the purpose to suppress competition is evidenced by repetitive lawsuits carrying the hallmark of insubstantial claims and thus is within the 'mere sham' exception announced in *Noerr*." *Otter Tail*, 410 U.S. at 380 (citing Cal. Motor Transp. Co. v. Trucking Unlimited, 404 U.S. 508, 513 (1972)).

552. This is one of numerous actions against Microsoft. In 1994, the government brought a civil complaint against Microsoft under sections 1 and 2 alleging, in part, that Microsoft had unlawfully maintained a monopoly of operating systems for IBM-compatible personal computers through certain anticompetitive marketing practices. *See* Proposed Final Judgment and Competitive Impact Statement, U.S. v. Microsoft Corp., 59 Fed. Reg. 42,845 (Aug. 19, 1994). In 1996, the DOJ brought a contempt action against Microsoft for tying its internet browser to its operating system in claimed violation of the consent decree. United States v. Microsoft Corp., 980 F. Supp. 537 (D.D.C. 1997). This action led to an injunction against Microsoft barring it from tying Internet Explorer ("IE") to Windows. *Id.* at 545. The injunction was subsequently reversed. *See* United States v. Microsoft Corp., 147 F.3d 935, 938 (D.C. Cir. 1998).

553. *See* United States v. Microsoft Corp., 253 F.3d 34, 45 (D.C. Cir. 2001).

554. A "Web browser" is a [product] that enables a user to select, retrieve, and perceive resources on the Web. In particular, Web browsers provide a way for a user to view hypertext documents and follow the hyperlinks that connect them, typically by moving the cursor over a link and depressing the mouse button.

United States v. Microsoft Corp., 84 F. Supp. 2d 9, 14 (D.D.C. 1999).

555. "An 'operating system' is a software program that controls the allocation and use of computer resources (such as central processing unit time, main memory space, disk space, and input/output channels). The operating system also supports the functions of software programs, called 'applications,' that perform specific user-oriented tasks." *Id.* at 12.

556. *See* Complaint ¶¶ 18–20, 103–22, *Microsoft* (No. 98-1232), *available at* http://www.usdoj.gov/atr/cases/f1700/1763.pdf.

need for an operating system.[557] In order to ensure that Microsoft's web browser, Internet Explorer, dominated the market, Microsoft gave it away for free.[558] In short, integration of the operating system combined with its free offering of Internet Explorer was designed to maintain Microsoft's monopoly power over the operating system market.[559]

Of particular interest in this case is Microsoft's response to the government's allegation. Specifically, Microsoft argued that its conduct was motivated by the procompetitive, disciplining effect of potential rivals and therefore it was not exercising market power.[560] Microsoft asserted that its operating system not only faced potential competition from other operating systems, but also from handheld devices and portal websites that would eliminate the need for its operating system and perhaps home computers altogether.[561]

Interestingly, Microsoft's use of potential competition was as an attempt to redefine the relevant product market, one that both the trial court[562] and the D.C. Circuit[563] rejected. The evidence in favor of Microsoft's position stemmed largely from its own documents and e-mails, highlighting the culture at Microsoft that perceived itself as constantly being threatened by the latest passing fancy.[564] Moreover, Microsoft pointed to its large research and development expenditures[565] and its low price for Windows[566] as evidence of its fear. This subjective evidence of Microsoft's beliefs with respect to competition, however,

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557. *Id.* ¶¶ 4–9, 66–68.

558. *Id.* ¶ 16.

559. *See* Nicholas Economides, United States v. Microsoft*: A Failure of Antitrust in the New Economy*, 32 UWLA L. REV. 3, 8 (2001); *see also* United States v. Microsoft Corp., 87 F. Supp. 2d 30, 39–43 (D.D.C. 2000).

> Specifically, the District Court held Microsoft liable for: (1) the way in which it integrated IE into Windows; (2) its various dealings with Original Equipment Manufacturers ("OEMs"), Internet Access Providers ("IAPs"), Internet Content Providers ("ICPs"), Independent Software Vendors ("ISVs"), and Apple Computer; (3) its efforts to contain and to subvert Java technologies; and (4) its course of conduct as a whole.

Microsoft, 253 F.3d at 58.

560. *See* Economides, *supra* note 559, at 23 ("Microsoft's Internal e-mails point to a real fear that the company would be overtaken by the next innovator."); *see also Microsoft*, 253 F.3d at 56–57 (noting Microsoft's argument "that it invests heavily in research and development and charges a low price for Windows") (citation omitted).

561. *See Microsoft*, 253 F.3d at 57.

562. *See* United States v. Microsoft, 65 F. Supp. 2d 1, 9–10 (D.D.C. 1999) (rejecting expansion of the relevant market beyond Intel-based operating systems).

563. *Microsoft*, 253 F.3d. at 57.

564. *See* Economides, *supra* note 559, at 23.

565. *Microsoft*, 253 F.3d at 56–57. Microsoft pointed to its entire research and development expenditure, not just the portion allocated to Windows. *Id.* at 57.

566. *Id.* at 56–57. The argument here was that Windows constituted a small portion of the cost of an Intel-based PC system. *Id.*

was apparently overcome by objective evidence.[567] Specifically, the D.C. Circuit upheld Judge Jackson's position that research and development expenditures were consistent with monopoly power.[568] As the D.C. Circuit noted:

> The R&D expenditures Microsoft points to are not simply for Windows, but for its entire company, which most likely does not possess a monopoly for all of its products. Moreover, because innovation can increase an already dominant market share and further delay the emergence of competition, even monopolists have reason to invest in R&D.[569]

Moreover, evidence suggested that Microsoft priced Windows without regard to the price its supposed competitors charged for their products.[570] In sum, Microsoft's subjective evidence was overcome by objective evidence establishing Microsoft's monopoly power, and a lack of concern about the pricing behavior of alleged potential competitors.

E. Regulated and Deregulated Markets

The concepts in the potential competition doctrine and entry analysis have distinct applications in regulated and recently deregulated markets. In some cases, regulation can create artificial entry barriers that moot out the ability of other firms to enter the market. Deregulation can create new opportunities for firms that have not traditionally served that market to enter. We provide brief surveys of various industries to discuss the application of the potential competition doctrine. We discuss the electricity, airline, telecommunications, banking, and railroad industries. As we demonstrate, the analysis of courts and administrative agencies has generally been inconsistent.

1. THE ELECTRICITY INDUSTRY

Federal and state agencies have traditionally regulated electricity generation, transmission, and distribution.[571] Typically, electric utilities

567. *See id.* at 57.

568. *Id.*

569. *Id.*

570. *Id.* at 57–58 ("[A]ccording to the District Court, the company set the price of Windows without considering rivals' prices, something a firm without a monopoly would have been unable to do.") (citation omitted).

571. *See generally* DARREN DAVID BUSH, CREATING COMPETITION IN ELECTRICITY GENERATION: RECONCILING THE PUBLIC UTILITY REGULATORY POLICY ACT OF 1978 WITH THE ENERGY POLICY ACT OF 1992 (1995) (Ph.D. Dissertation, University of Utah).

were integrated and sold their energy to households and businesses in their exclusive service territories: end users had no alternative.[572] However, due to increased integration among utilities and rising wholesale energy prices in the 1970s,[573] wholesale energy markets began to flourish in the early 1980s.[574] As a result, if one could convince the incumbent utility to transmit that power to the consumer who demanded it, then conceivably one could experience competition at the wholesale level. The municipalities sought this type of competition in *Otter Tail*.[575] However, in cases where state law currently prohibits competition (and a consumer is stuck with the incumbent utility), courts have sometimes struck monopolization claims.

The Pennsylvania cases, *Schuylkill Energy Resources, Inc. v. Pennsylvania Power & Light Co.*, and *City of Pittsburgh v. West Penn Power Co.*, illustrate this issue.[576] During the appeal of these two cases, the State of Pennsylvania enacted the Electricity Generation Customer Choice and Competition Act ("the Act").[577] The Act allowed for phased-in competition on a retail basis, with retail access pilot programs beginning in April 1997.[578] The law called for one-third of the state's consumers to have access to multiple power providers by January 1, 1999, two-thirds by January 1, 2000, and all consumers by January 1, 2001.[579]

Schuylkill Energy Resources ("SER") brought monopolization and attempted monopolization claims under section 2 against Pennsylvania Power and Light ("PPL").[580] SER was a qualifying facility, which meant that PPL was obligated to purchase power from SER.[581] In October 1986, SER and PPL entered into a power purchase agreement, which bound SER to "sell exclusively to [PPL]," while PPL was "required to purchase SER's entire net power output up to 79.5 megawatts."[582] PPL was permitted to purchase less than SER's total

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572. *See id.* at 15–16.

573. *See id.* at 22–23.

574. *See id.* at 32–36.

575. *See supra* notes 537–51 and accompanying text.

576. City of Pittsburgh v. W. Penn Power Co., 147 F.3d 256 (3d Cir. 1998); Schuylkill Energy Res., Inc. v. Pa. Power & Light Co., 113 F.3d 405 (3d Cir. 1997).

577. 66 PA. CONS. STAT. ANN. §§ 2801-2812 (West 2000).

578. *Id.* § 2804.

579. *Id.* § 2806.

580. *Schuylkill*, 113 F.3d at 412.

581. *Id.* at 411 (citing the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, § 210, 92 Stat. 3144, 3144–47) (codified as amended in scattered sections of 16 U.S.C.)). Section 210 requires that the utility purchase power from a facility that meets certain energy efficiency requirements at a rate equal to the avoided cost. *Id.* § 210(a)–(b), 92 Stat. at 3122; *see* BUSH, *supra* note 571, at 86.

582. *Schuylkill*, 113 F.3d at 411.

output in instances where there was a "system emergency."[583] However, PPL could not reduce SER's output simply because it could secure cheaper power from other sources.[584] During the course of the contract, it was alleged that PPL declared system emergencies that reduced SER's output such that PPL could then obtain cheaper power elsewhere, in violation of PPL's contract with SER.[585] In its complaint, SER alleged that PPL's declarations of system emergencies were not system emergencies and caused SER to incur costs.[586] SER's complaint stated that PPL's conduct deprived consumers of an energy source and that an energy source is not the same as a competitor.[587] PPL moved to dismiss the complaint, or in the alternative, asked the district court to stay the proceeding and refer the case on primary jurisdiction grounds to the Pennsylvania Public Utilities Commission ("PUC").[588] The district court agreed to stay the proceedings and eventually dismissed the case.[589] SER appealed.[590]

The Third Circuit affirmed the district court and disposed of SER's potential competition claim.[591] The court stated that the number of energy suppliers is immaterial, given that "[c]onsumers within [PPL's] service area would still receive the same product (electricity) and the same amount of competition (none)."[592] SER attempted to show that SER was PPL's competitor in the provision of power to end users, with PPL's distribution arm acting as a middleman:

> [PPL] gets reimbursed dollar for dollar from its customers . . . . Therefore, SER, to all intents and purposes, is selling its power to the public with [PPL] acting as a distribution agent or middleman. . . . SER, therefore, is a

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583. *Id.* A "system emergency" was defined to include "minimum generation emergencies and minimum generation events." *Id.* (internal quotations omitted). Minimum generation events "occur when the aggregate power demand within the regions serviced by PJM [the Pennsylvania-New Jersey-Maryland Interconnection] is expected to fall below its normal or emergency minimum generation floor level and PJM cannot sell the . . . excess power to [others]." *Id.* at 411-12.

584. *Id.* at 411.

585. *Id.* at 412.

586. *Id.* ("In other words, when total electric power available for distribution by PJM exceeds aggregate customer demand, [PPL] disproportionately curtails the purchase of electric energy generated by SER and other independent power producers.").

587. *Id.* at 414.

588. *Id.* at 412.

589. *Id.* Schuylkill Energy Resources' ("SER") initial complaint did not include Sherman Act claims. SER added these claims after the court issued its stay order. *Id.*

590. *Id.*

591. *Id.* at 419.

592. *Id.* at 414.

> competitor with [PPL] for the sale of electric energy to [PPL]'s consumers within [PPL]s service area.[593]

The court rejected this argument, stating that SER "is not [PPL]'s *competitor*—it is [PPL]'s *supplier*."[594] Not only did the power purchase agreement prohibit SER from selling in the market in which PPL competed, but then existing state and federal law also prohibited SER from providing power directly to end-users.[595]

However, the court acknowledged that the state was planning retail competition, but dismissed its import.[596] SER argued that PPL's actions would injure its ability to compete with PPL in the retail market in the future.[597] The court declined SER's invitation to consider PPL's motives in light of the regulatory changes:

> The Choice and Competition Act comes too late for SER's Amended Complaint. Competitive retail access will be phased in over time, and direct access to competition will not exist across Pennsylvania until January 1, 2001.[598] Competitive retail access pilot programs did not begin until April 1, 1997, long after SER filed its Amended Complaint, and [these programs] are only available to five percent of "peak load."
>
> . . . .
>
> We will not attempt to predict the future of competitive retail access in Pennsylvania. We do not know whether SER or [PPL] will even exist in 2001, and we certainly do not know whether [PPL] will enjoy an unlawful monopoly in its service area at that time.[599]

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593. *Id.* at 415 (first omission in original) (quoting SER's Am. Compl. ¶¶ 24–25).

594. *Id.* SER did not allege that it competed with Pennsylvania Power and Light's ("PPL") generation for the provision of wholesale electric power to PPL.

595. *Id.*

596. *Id.* at 416.

597. *Id.*

598. Note that the court ignores the fact that one-third of the retail energy market would be open to choice by January 1, 1999, a year and a half from the date of the court's decision.

599. *Id.* (citation omitted). The court may have also been concerned about SER taking advantage of the passage of Pennsylvania's competition statute to bolster its case: SER filed its original complaint well in advance of the passage of Pennsylvania's Electricity Generation Customer Choice and Competition Act ("the Act").

While it is clear that SER is not currently PPL's competitor, the court misses the point when discussing the inception of retail competition in Pennsylvania. It is clear that at a date certain—and maybe even to some degree at the date of the opinion—PPL and SER will be competitors. The Qualifying Facilities Agreement ("QF Agreement") requiring PPL to purchase power from SER (and for SER to sell power to PPL) that the court points to was unlikely to exist at the time competition would commence in Pennsylvania.[600] By creating competitive difficulties for future competition now, PPL may have been positioning itself as the strongest retail competitor once competition commenced.[601] Thus, the conduct that SER points to may have been an attempt to monopolize, or monopolization of, future retail markets by excluding potential competitors today.

Another incumbent utility strategy to cope with upcoming retail competition is to bulk up in size to pose a formidable threat to competitors on day one of competition. Bulking up may include merging with a potential competitor. In *West Penn*, the City of Pittsburgh brought an action to enjoin the merger of Allegheny Power ("AP") and Duquesne Light Company ("DLC").[602] The City had sought to revitalize areas of its downtown by bringing in industrial and commercial interests.[603] These businesses were seduced by cheaper electric retail rates than DLC current rates.[604] DLC was the monopoly incumbent in downtown Pittsburgh and Pennsylvania's deregulation of the electricity market had not yet occurred.[605] In order to obtain cheaper rates, the City sought bids.[606] AP's bid was significantly lower than DLC's bid.[607] The City petitioned PUC to approve the deal and grant AP authority to sell power to the City and AP intervened in support of the City's motion.[608] DLC opposed these applications.[609]

600. In deregulating electricity markets, qualifying facilities contracts are typically thrown into the amount that utilities are compensated for stranded costs, allowing the utility to "buy out" of the contract and freeing the generator to compete.

601. PPL continues to market energy and build power plants in Pennsylvania in competition with independent producers.

602. *W. Penn*, 147 F.3d. at 258.

603. *Id.* at 259.

604. *See id.*

605. *Id.* at 260.

606. *Id.* at 261. Only Duquesne Light Company ("DLC") and Allegheny Power ("AP") had authority to sell power within Allegheny County, Pennsylvania. *See id.* at 260-61. Thus, while the court does not make clear whether other bids were submitted, it is likely that these two utilities were the only ones capable of submitting bids.

607. *Id.* at 261.

608. *See id.* 260-61. At the time these maneuvers were taking place, the Act had yet to be passed. *See id.* at 260.

609. *Id.*

Prior to a resolution of this matter, DLC and AP announced their intention to merge.[610] AP then filed a petition to withdraw as an intervenor in the City's pending PUC motion.[611] The City alleged that, under the premerger agreement, "the two utilities agreed that they would not file any applications with the government without prior consultation" with the other party.[612] While AP was not a current competitor, it is clear that it was a potential competitor, having won a bid with the City to supply power.[613]

However, the district court concluded that AP and DLC were never competitors.[614] The court noted that under current regulations, they were precluded from competition absent PUC approval and in any event the firms agreed not to compete.[615] Finally, the court concluded that prospective competition was too speculative.[616] The Third Circuit affirmed, relying heavily on *Schuylkill*.[617]

The Third Circuit first noted that, while the City alleged that the merger eliminated "actual and prospective competition between [AP] and [DLC]," no actual competition took place, despite the submission of a bid and filings with the PUC to allow AP to provide power to the City.[618] The court concluded that the sole issue was whether there was "prospective competition."[619]

The court concluded that prospective competition was too attenuated.[620] The court "[did] not know whether the PUC would ever have granted" AP authority to serve the City.[621] Thus,

> [T]he court cannot conclude that the loss of potential competition was causally related to the decision of the two power companies to merge. The City is really claiming that it would have benefited from competition it *hoped would occur*. . . . The presence of the regulatory scheme and need for approval in connection with the choice of utilities . . . cuts the causal chain and converts what might have been deemed

610. *Id.* at 261.
611. *Id.*
612. *Id.*
613. *Id.*
614. *Id.* at 262.
615. *Id.*; *see also* City of Pittsburgh v. W. Penn Power Co., 993 F. Supp. 332, 337 (W.D. Pa. 1998). This conclusion apparently also considers the notion that the merger occurred before Pennsylvania's Public Utility Commission ("PUC") could rule on whether AP *could* supply the city. *See W. Penn*, 993 F. Supp. at 337.
616. *W. Penn*, 147 F.3d at 262.
617. *See id.* at 269.
618. *Id.* at 267. "[AP] was not legally able to provide power in the [City]." *Id.*
619. *See id.*
620. *Id.*
621. *Id.*

> antitrust injury in a free market into only a speculative exercise.[622]

And, the injury may never have occurred. In short, the PUC *may* have ruled against the City and denied its request, thus making any injury suffered by the City the result of regulatory action and not an antitrust violation.

The court, however, proves too much and leaves future plaintiffs in similar circumstances in a bind. The City could have continued its petition with PUC, but the merger would have mooted it. The PUC petition would further be weakened because AP had withdrawn its bid.[623] Moreover, there was very convincing evidence that the potential competition that was to take place was not speculative. After all, AP and DLC had bid.[624] When the City petitioned PUC, both AP and DLC intervened.[625] Once AP and DLC agreed to merge, AP withdrew from the proceedings as part of a premerger agreement.[626] And, even if PUC denied the City's petition, retail choice was imminent in the state because of the Act.[627] Not only was competition between AP and DLC likely, but one could argue that it had already taken place.

United States v. Rochester Gas & Electric Corp.[628] reaches the opposite results of *Schuylkill* and *West Penn*. In the late 1980s or early 1990s, the University of Rochester convened a special task force to determine the feasibility of constructing and operating a cogeneration plant to produce its own energy.[629] The task force concluded that if the university constructed a plant, one-third of its output could be sold to other users.[630] The government contended that the university considered selling power to other consumers.[631]

Shortly after the university's Board of Trustees approved the plan to build a plant, Rochester Gas and Electric ("RG&E") approached the university with a plan to sell electricity at a discounted rate and "provide other financial incentives that would negate any savings that would have been realized through the school's production of its own steam and

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622. *Id.* at 267–68. The court believed that the City had not "explicitly argued" their case under "potential competition" theory, but that support to the City's argument would be "doubtful" under that theory. *Id.* at 267 n.19.

623. *See id.* at 261.

624. *Id.* at 267.

625. *Id.* at 260–61.

626. *Id.*

627. *See id.* at 260.

628. 4 F. Supp. 2d 172 (W.D.N.Y. 1998).

629. *Id.* at 173. A cogeneration plant produces electricity and steam. *Id.* The former is used to power computers, etc., and the latter is used for heating purposes. *Id.*

630. *Id.* at 174.

631. *Id.*

electricity."[632] In exchange for these incentives, the university agreed to remain an RG&E customer until December of 2000 and agreed "not to solicit or join with other customers of RG&E to participate in any plan designed to provide them with electric power and/or thermal energy from any source other than RG&E."[633] The government alleged a section 1 violation.[634]

The parties filed cross-motions for summary judgment.[635] RG&E moved for summary judgment and argued that "the University was neither a competitor, nor a potential competitor in the electricity market."[636] RG&E asserted that significant barriers prevented the university's entry into the electricity market:

> RG&E points out that if the U [of] R had attempted to sell electric power, it would have had to first obtain approval from the Public Service Commission, and then it would have been subject to the Commission's regulatory control, (unless it came under a narrow exception applicable to certain cogeneration facilities). Also, if the University were to sell electricity to the Rochester Institute of Technology, it would have had to apply for and have had approved franchises from the City of Rochester and the towns of Brighton and Henrietta to deliver the electricity. RG&E claims that because the Government has failed to demonstrate that the University could have actually competed with it, the plaintiff's claim is too speculative, and must be dismissed.[637]

The court rejected RG&E's position on two grounds. First, the affidavits provided by the university in support of RG&E's motion were at odds with depositions taken of university administrators.[638] And, while regulatory obstacles existed, the court held that the question of whether the university intended to compete with RG&E was a question of fact for the jury.[639]

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632. *Id.*
633. *Id.*
634. *Id.* at 173.
635. *Id.*
636. *Id.* at 176.
637. *Id.* at 177.
638. *Id.*
639. *Id.*

2. THE AIRLINE INDUSTRY

Airline incumbents periodically use potential competition as a defense to allegations that their conduct precludes entry.[640] Specifically, the incumbent fears any level of competition. While the airline incumbent charges monopoly prices in the short term, it may lower fares to competitive (or below competitive) levels and significantly increase capacity on the route once it receives information that a competitor may enter. This conduct may eliminate the threat of competition because entry is no longer profitable. Once the threat is eliminated, prices return to monopoly levels. This problem has generated a great deal of attention[641] as well as major antitrust suits.[642]

In 1999, the government filed a complaint alleging that American Airlines ("AA") had monopolized or attempted to monopolize air passenger service to and from its Dallas-Fort Worth Airport ("DFW") hub.[643] AA operated a very large number of flights between DFW and

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640. This is the "minority report" defense. Specifically, in the movie *Minority Report*, murderers are apprehended before the murder takes place. MINORITY REPORT (Dreamworks Pictures 2002). Similarly, the minority report defense proclaims that competitors shall be eliminated before they enter.

641. There has been a great deal of academic interest in airline predatory tactics over the years. *See, e.g.*, Robert G. Berger & Stephanie J. Mitchell, *Predatory Pricing in the Airline Industry: A Case Study—The Policies and Practices of the CAB*, 13 TRANSP. L.J. 287 (1984); Mark T. Clouatre, *The Legacy of* Continental Airlines v. American Airlines*: A Re-Evaluation of Predatory Pricing Theory in the Airline Industry*, 60 J. AIR L. & COM. 869 (1995); Einer Elhauge, *Why Above-Cost Price Cuts to Drive Out Entrants Are Not Predatory—and the Implications for Defining Costs and Market Power*, 112 YALE L.J. 681 (2003); Russell A. Klingaman, *Predatory Pricing and Other Exclusionary Conduct in the Airline Industry: Is Antitrust Law the Solution?*, 4 DEPAUL BUS. L.J. 281 (1992). For an innovative solution to predatory pricing, see Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy*, 88 GEO. L.J. 2239 (2000).

The U.S. Department of Transportation had proposed guidelines to regulate such practices, Enforcement Policy Regarding Unfair Exclusionary Conduct in the Air Transportation Industry, 63 Fed. Reg. 17,919 (Apr. 10, 1998), but these guidelines were never adopted.

642. The case law is replete with allegations suggesting that the major airlines have engaged in predatory conduct against entrants. *See, e.g.*, Int'l Travel Arrangers v. NWA, Inc., 991 F.2d 1389, 1394 (8th Cir. 1993); Pac. Express, Inc. v. United Airlines, Inc., 959 F.2d 814, 815 (9th Cir. 1992); Cont'l Airlines, Inc. v. Am. Airlines, Inc., 824 F. Supp. 689, 692–93 (S.D. Tex. 1993); *In re* Passenger Computer Reservations Sys. Antitrust Litig., 694 F. Supp. 1443, 1451 (C.D. Cal. 1988), *aff'd sub nom.* Alaska Airlines, Inc. v. United Airlines, Inc., 948 F.2d 536 (9th Cir. 1991); Brian Clewer, Inc. v. Pan Am. World Airways, Inc., 674 F. Supp. 782, 784, 788 (C.D. Cal. 1986) (granting defendants' motion to dismiss plaintiff's claims that defendant airlines priced their tickets to drive a competitor affiliated with plaintiff out of business).

643. United States v. AMR Corp., 140 F. Supp. 2d 1141, 1192 (D. Kan. 2001) ("*AMR I*"), *aff'd*, 335 F.3d 1109 (10th Cir. 2003) ("*AMR II*").

other cities.[644] When a low cost carrier ("LCC") entered a DFW route, AA matched the LCC fares, increased capacity—that is, added new flights or increased the size of planes for existing scheduled service—and adjusted its yield management system to allow more seats to be available at the lower fares.[645] Once the LCC ceased or moved operations, AA resumed its prior operations, increasing fares and reducing capacity somewhat to levels comparable to the period before LCC competition.[646] The U.S. Court of Appeals for the Tenth Circuit interpreted the government's complaint "[a]t its root" to allege that AA: "(1) priced its product on the routes in question below cost; and (2) intended to recoup these losses by charging supracompetitive prices either on the four core routes themselves, or on those routes where it stands to exclude competition by means of its 'reputation for predation.'"[647] The district court granted summary judgment to AA and the Tenth Circuit affirmed, finding the government's measures of predatory pricing "invalid as a matter of law, fatally flawed in their application, and fundamentally unreliable."[648]

One aspect of the government's case can be seen as raising issues related to the potential competition concept. First, the government alleged that AA responded to an entrant's announcement of its intent to begin operation over routes from DFW.[649] Specifically, in September of 1996, Vanguard Airlines announced that it would begin nonstop service between DFW and a few other cities.[650] Vanguard was already flying a route between Wichita and DFW in competition with AA.[651] AA responded initially by lowering fares on an increasing number of seats over the route.[652] However, after Vanguard's announcement of new service, AA responded by expanding capacity by 35% between Wichita and DFW.[653] The government alleged that AA "lost money on the capacity increase," but that the conduct "got Vanguard out" of the route.[654] Once Vanguard exited the route, the government alleged that

644. *AMR I*, 140 F. Supp. 2d at 1146.

645. *AMR II*, 335 F.3d at 1112.

646. *Id.*

647. *Id.* at 1111.

648. *Id.* at 1111, 1120. Predatory pricing cases habitually have been dismissed on summary judgment and the court in this case followed the trend. *See, e.g.*, Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 212 (1993); Cargill, Inc. v. Monfort of Color., Inc., 479 U.S. 104, 117 (1986); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 598 (1986).

649. Brief for Appellant at 16, *AMR II* (No. 01-3202), *available at* http://www.usdoj.gov/atr/cases/f9800/9814.pdf.

650. *Id.*

651. *Id.*

652. *Id.*

653. *Id.*

654. *Id.* at 17.

AA "decreased capacity 30 percent and raised fares over 50 percent."[655] The government alleged similar events in the other three routes Vanguard ultimately entered.[656] Furthermore, the government alleged that AA's conduct would serve as notice to would-be entrants on DFW routes that they would face a similar response.[657]

The use of potential competition in *United States v. AMR Corp.* is interesting in that it can present challenges for both plaintiffs and defendants. For example, the district court found that other LCCs were establishing service over other DFW routes.[658] Therefore, a plaintiff might find itself in the position of arguing that LCCs will not only enter certain DFW routes, but for AA's conduct, but, to the extent that they are currently providing service in the predation markets, that level of service would be higher in the absence of predation. The difficulty in this approach lies in where to find proof. LCCs have an interest in asserting that they would have entered but for AA's reputation because a DOJ victory might eliminate competitive pressure placed on the LCCs by AA. But other factors leading to an LCC's decision to abandon entry plans are also difficult to dismiss, such as an inability to obtain sufficient capital—even though limited access to capital may be tied to the incumbent's behavior or misinformation about the market.

Defendants also face challenges. A defendant may argue that airline markets are national in scope—any airline may enter any route at any time. However, such an argument makes it difficult for the airline to assert that it is acting rationally by reducing fares after entry of an LCC. In theory, fares should already be low because of the existence of a number of large, established airlines. Unfortunately, the court's predation analysis of a monopolization case permits an incumbent airline to engage in any conduct so long as the airline does not lower fares below some still undefined and ambiguous measure of incremental cost.[659]

3. THE COMMUNICATIONS INDUSTRY

Technological and regulatory changes have created interesting applications of the potential competition concept in the communications industry. Various communication technologies have converged to offer

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655. *Id.*

656. *Id.* at 14.

657. *See id.* at 20.

658. *See AMR I*, 140 F. Supp. 2d at 1188. The court pointed out in its opinion that six new carriers had entered DFW routes since 1995. *Id.*

659. For good critiques of the district court's test and proposals for other tests, see Patrick Bolton, Joseph F. Brodley & Michael H. Riordan, *Predatory Pricing: Response to Critique and Further Elaboration*, 89 GEO. L.J. 2495 (2001), and Aaron S. Edlin, *Stopping Above-Cost Predatory Pricing*, 111 YALE L.J. 941 (2002).

very similar services, possibly making potential rivals out of firms that historically could not compete.[660] Significant regulatory changes have also broken down regulatory barriers that prevented entry, while other changes have restricted the activities of incumbents to encourage new competition.[661]

The Federal Communications Commission (FCC) regulates mergers under a fairly open-ended public interest standard, where competition is but one factor the agency considers.[662] While the FCC's public interest review has always had a competitive component, one observer has noted that beginning in the mid-1990s, the FCC's decisions have weighed competitive considerations more heavily.[663] The FCC's competitive considerations also diverge somewhat from traditional antitrust analysis of mergers in that the agency may seek to impose conditions to a merger that enhance competition rather than simply preserve the competitive status quo.[664] The DOJ also has jurisdiction to bring antitrust suits in

660. For example, wireless telephone technology may rival wireline long distance and local phone service in many places. *See* Salvatore Massa et al., *Pricing Network Elements Under the Telecommunications Act of 1996: Back to the Future*, 23 HASTINGS COMM. & ENT. L.J. 751, 768 (2001). The cable television industry is also beginning to provide voice grade telecommunications service. Other technologies are simply new and may pose competitive threats to incumbents. Direct broadcast satellite service is providing an alternative for consumers to cable television. *See In re* Implementation of the Cable Television Consumer Protection & Competition Act of 1992, 17 F.C.C.R. 12,124, 12,144 (2002).

661. Two significant pieces of legislation in this regard are the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (codified in scattered sections of 47 U.S.C.), and the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified in scattered sections of 47 U.S.C.).

662 *See* 47 U.S.C. § 309; *see also* United States v. FCC, 652 F.2d 72, 88 (D.C. Cir. 1980) ("The agency's determination about the proper role of competitive forces in an industry must therefore be based, not exclusively on the letter of the antitrust laws, but also on the 'special considerations' of the particular industry.").

663. Jason E. Friedrich, Comment, *Thinkable Mergers: The FCC's Evolving Public Interest Standard*, 6 COMMLAW CONSPECTUS 261 (1998). Jason E. Friedrich explains: "In the pre-1996 [Telecommunications] Act environment, the positive attributes of competition in the communications sector were not universally accepted. With the passage of the 1996 Act, the Commission has taken the hint from Capitol Hill that additional competition in the communications sector is synonymous with the public interest." *Id.* at 265.

664. For example, in one merger review, the Federal Communications Commission (FCC) suggested the standard for approving a merger was whether it enhances competition. *See In re* Applications of Ameritech Corp. & SBC Communications Inc., 14 F.C.C.R. 14,712 (1999), *vacated in part on other grounds by* Ass'n of Communications Enter. v. FCC, 235 F.3d 662 (D.C. Cir. 2001). The FCC stated:

> While an antitrust analysis, such as that undertaken by the DOJ in this case, focuses solely on whether the effect of a proposed merger "may be substantially to lessen competition," the Communications Act requires the Commission to make an independent public interest determination, which

this sector.[665] Thus, both agencies may challenge mergers, although the FCC's review is broader.[666]

These regulatory changes have inspired the use of the potential competition concept in several areas. First, the FCC itself has taken an interest in the potential competition concept in rulemaking proceedings in order to limit monopolistic behavior.[667] Second, the FCC has employed the actual potential competition doctrine when reviewing telecommunications mergers.[668] The FCC has adapted the actual potential competition doctrine as interpreted by the case law and the Agencies' merger guidelines. The FCC has established a five-prong test:

> The doctrine of actual potential competition has five elements: (1) the market in question ("the target market") is highly concentrated; (2) few other potential entrants are "equivalent" to the company that proposes to enter the target market by merger . . . (3) the company entering the target market by merger would have entered the market but for the proposed merger; (4) that company had other feasible means of entry;

> includes evaluating public interest benefits or harms of the merger's likely effect on future competition. In order to find that a merger is in the public interest, therefore, the Commission must "be convinced that it will enhance competition."

Id. at 14,738 (footnotes omitted).

665. Prior to 1996, the FCC could immunize certain transactions, precluding the DOJ's ability to bring suits. *See* 47 U.S.C. § 221(a) (1994); S. CONF. REP. No. 104-230, at 200-01 (1996). Even prior to 1996, the FCC rarely used its power to confer immunity.

666. However, the differing approaches of the FCC and the DOJ sometimes lead to different results. For example, the FCC may find a particular transaction in the public interest even though the DOJ may allege that it is anticompetitive. *See, e.g.*, *FCC*, 652 F.2d at 99. Alternatively, the FCC may impose conditions to enhance competition or preserve certain aspects of competition that the DOJ has not sought. *See infra* text accompanying notes 669–72.

667. *See, e.g.*, *In re* Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992, 16 F.C.C.R. 17,312, 17,345 (2001); *In re* Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, 12 F.C.C.R. 15,756, 15,775–76 (1997).

668. *See, e.g.*, *Ameritech & SBC Communciations*, 14 F.C.C.R. at 14,745; *In re* Applications of P.R. Tel. Auth. & GTE Holdings (Puerto Rico) LLC, 14 F.C.C.R. 3122, 3130–31 (1999); *In re* Application of Worldcom, Inc. & MCI Communications Corp. for Transfer of Control of MCI Communications Corp. to Worldcom, Inc., 13 F.C.C.R. 18,025, 18,038 (1998); *In re* Applications of NYNEX Corp. & Bell Atl. Corp., 12 F.C.C.R. 19,985, 20,012–13 (1997); *In re* Merger of MCI Communications Corp. & British Telecomms. plc, 12 F.C.C.R. 15,351, 15,367–68 & 15,368 n.59 (1997); *In re* Applications of Pac. Telesis Group & SBC Communications, Inc., 12 F.C.C.R. 2624, 2634 (1997).

> and (5) such alternative means of entry offer a substantial likelihood of ultimately producing deconcentration in the target market or other significant pro-competitive effects.[669]

The FCC, however, acknowledges that it has departed from a mechanistic application of the 1984 Guidelines. For example, the FCC has failed to follow the 1984 Guidelines' safe harbor provision for acquisitions where more than three potential competitors exist. The FCC has explained: "[i]n telecommunications markets that are virtual monopolies or that are not yet developed, however, the loss of even one significant market participant can adversely affect the development of competition and the attendant proposals for deregulation."[670]

In applying the doctrine, the FCC also tried to rely on federal case law.[671] However, it took a more liberal interpretation of the cases. On the question of what standard of proof was necessary to show that a potential competitor would actually enter the market, the FCC said: "[t]he more authoritative and reasonable case law applying the doctrine of actual potential competition requires only a showing that a company was reasonably likely to enter, not that entry be certain as shown by vote of the Board of Directors or by the commitment of resources."[672] Notably, as our discussion of the federal court interpretations of the doctrine suggest,[673] this may be a rather hopeful view of the cases.

In two of the recent transactions the FCC has reviewed, it has found that the elements of an actual potential competition claim were satisfied.[674] Although it did not block those mergers, the FCC did place conditions on the transactions.[675] In the Bell Atlantic Corporation ("Bell Atlantic") combination with NYNEX Corporation ("NYNEX"), the FCC found that Bell Atlantic was a potential competitor of NYNEX,

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669. *Pac. Telesis Group & SBC Communications*, 12 F.C.C.R. at 2634 (footnotes omitted).

670. *NYNEX & Bell Atl.*, 12 F.C.C.R. at 20,026. This more cautious approach toward embracing mergers is somewhat in contrast to other FCC decisions. For example, in *United States v. FCC*, the agency approved a joint venture between two potential entrants in the domestic satellite communication business. 652 F.2d at 74. It found that a joint venture between two potential firms was necessary because they would otherwise not enter the market alone. *Id.* at 100. While the federal appellate court questioned whether the FCC's conclusion was truly "correct," it deferred to the agency's determination because it was reasonable under its broad public interest standard. *Id.* at 100, 104.

671. *NYNEX & Bell Atl.*, 12 F.C.C.R. at 20,026.

672. *Id.* at 20,026–27.

673. *See supra* Part II.B.2.

674. *See Ameritech & SBC Communications*, 14 F.C.C.R. 14,712; *NYNEX & Bell Atl.*, 12 F.C.C.R. 19,985.

675. *Ameritech & SBC Communications*, 14 F.C.C.R. at 14,716; *NYNEX & Bell Atl.*, 12 F.C.C.R. at 19,992.

particularly in the New York metropolitan area.[676] Both NYNEX and Bell Atlantic were essentially monopolists in the provision of wireline local telephone service to households and smaller businesses in their territories.[677] The firms' territories were adjacent to each other, but neither had entered the other's territory.[678]

However, Bell Atlantic internal documents generated by middle managers apparently suggested that the firm was looking across the Hudson River and planning to enter NYNEX's New York market.[679] While the FCC identified other potential competitors—AT&T, MCI, and Sprint—the agency found that Bell Atlantic was better positioned as a potential entrant.[680] Its adjacent territory permitted Bell Atlantic to access nearby facilities to serve the New York market.[681] The firm's proximity to NYNEX also provided it with extremely good brand recognition in the area.[682] Bell Atlantic was also very experienced in wireline operations and had some knowledge of the New York market because of its cellular operations.[683] Documents suggested that New York consumers viewed Bell Atlantic as a strong "second choice" to provide local wireline service.[684] Furthermore, the capital investment

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676. *NYNEX & Bell Atl.*, 12 F.C.C.R. at 20,028.

677. The territories of local wireline telephone firms dates to the government's case against AT&T, which broke off AT&T as a long distance company and then created seven regional Bell operating companies ("RBOCs") which each provided wireline local service in their service areas. NYNEX Corporation ("NYNEX") and Bell Atlantic Corporation ("Bell Atlantic") were both RBOCs. *See* United States v. W. Elec. Co., 569 F. Supp. 1057, 1062 & n.5 (D.D.C. 1983), *aff'd sub nom.* California v. United States, 464 U.S. 1013 (1983); United States v. AT&T, 552 F. Supp. 131, 141-42 & 142 n.41 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 460 U.S. 1001 (1983). While the consent decree created territories for the RBOCs, it did not preclude any RBOC from expanding into another RBOC's territory to compete with it. However, numerous states imposed regulatory barriers to entry that were gradually being removed during the mid-1990s. *See* Samuel F. Cullari, Comment, *Divestiture II: Is the Local Loop Ripe for Competition?*, 3 COMMLAW CONSPECTUS 175, 182 (1995); Craig D. Dingwall, *The Last Mile: A Race for Local Telecommunications Competition Policy*, 48 FED. COMM. L.J. 105, 115-16 (1995).

678. State regulatory barriers prevented NYNEX's entry into parts of Bell Atlantic's territory. *See NYNEX & Bell Atl.*, 12 F.C.C.R. at 20, 2025. In contrast, the New York Public Service Commission was more active in promoting local competition in the state, giving Bell Atlantic a better opportunity to enter the territory. *See Re* Telecomms. Interconnection Arrangements, Open Network Architecture, and Comparably Efficient Interconnection, 128 Pub. Util. Rep. 4th (PUR) 97 (N.Y. Pub. Serv. Comm'n 1991).

679. *NYNEX & Bell Atl.*, 12 F.C.C.R. at 20,025-26.

680. *Id.* at 20,024-25.

681. *Id.* at 19,990-91.

682. *Id.* at 20,029.

683. *Id.* at 19,995, 20,027-28, 20,033.

684. *Id.* at 20,040.

and costs of developing a reliable brand for this market made entry generally difficult.[685]

Under the FCC's framework, the number of competitors would be reduced from five to four with the transaction, leaving open the question of how significant of a market force Bell Atlantic would have been. To resolve this question, the agency followed the approach of the 1992 Guidelines, and endeavored to calculate the HHI of the market both before and after the transaction to determine the impact that Bell Atlantic's entry would have on the market.[686] Relying on confidential market research to estimate market shares, it concluded that the change in HHI was significant enough to find an anticompetitive effect.[687] Furthermore, as noted above, the agency was also concerned that the elimination of potential competition during a transition toward deregulation could slow the road toward competition in what was an essentially nascent market.

The proposed merger between SBC Communications, Incorporated ("SBC") and Ameritech Corporation ("Ameritech") was set in a very similar context.[688] SBC and Ameritech both provided local wireline phone service to customers in adjacent territories.[689] Both firms provided cellular service in the other's territory and thus had a customer base to enlist for new wireline service.[690] And, both had brand recognition in the other's territory.[691] Finally, both firms had at least contemplated entering each other's territory to provide local wireline service.[692] Ameritech, in particular, had developed "Project Gateway," a plan to serve wireline service in SBC's St. Louis territory.[693] Ameritech even conceded to a state regulatory board that its Project Gateway plans were abandoned after discussions with SBC commenced.[694] Originally, Project Gateway was designed to be a "testbed" for more entry—perhaps in others parts of SBC's territory.[695]

While less damning, the FCC found some evidence that SBC was contemplating entry into Ameritech's service area.[696] It noted, for example, that in another proceeding, an SBC official testified that Chicago, which is located in Ameritech's service area, was a logical

685. *See id.* at 20,031.
686. *See* 1992 GUIDELINES, *supra* note 352, § 1.5.
687. *NYNEX & Bell Atl.*, 12 F.C.C.R. at 20,056-57.
688. *See Ameritech & SBC Communications*, 14 F.C.C.R. 14,712.
689. *Id.* at 14,719-20.
690. *Id.* at 14,741, 14,753-54.
691. *Id.* at 14,741.
692. *Id.* at 14,749-50.
693. *Id.* at 14,754.
694. *Id.*
695. *Id.*
696. *Id.* at 14,751-52.

place for SBC to offer wireline service.[697] SBC documents suggested that, while there were no plans for immediate entry, "when the competitive landscape became clear," the firm might enter.[698] The FCC also relied on Ameritech internal documents that characterized SBC as a threat to enter Chicago.[699]

The FCC was less rigorous in its analysis of the impact of the merger and did not attempt to calculate the market HHI as it did in the Bell Atlantic-NYNEX proceedings. It presumed a similar impact even though three other potential entrants were identified: AT&T, Sprint, and MCI.[700] However, like the Bell Atlantic-NYNEX transaction, the merger's primary impact was on the mass market, individual households, and small businesses. For larger and medium size businesses, "a large number of other firms may have similar capabilities and incentives [in] expanding out-of-region to serve larger business customers."[701]

Even under its liberal approach, the FCC has dismissed the vitality of potential competition claims in other proceedings. Three factors have definitely sounded the death knell for actual potential competition claims: internal documents from the potential entrant demonstrating intent are lacking; the territories of the firms were not truly adjacent; and the market presence of the potential entrant in the incumbent's territory was insignificant.[702]

No federal case law on the potential competition doctrine has developed in the communications area since these significant regulatory changes. The DOJ has not litigated a potential competition case, although it reached a consent decree in the Ameritech-SBC transaction.[703] The DOJ placed fewer conditions on the Ameritech-SBC merger than the FCC. And, it concluded that Ameritech's divestiture of its cellular assets in St. Louis—where the firms were already providing cellular services—was sufficient to address any potential competition concerns from the merger.[704] The FCC's remedy to the potential competition problem went much further.[705]

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697. *Id.*

698. *Id.* at 14,752.

699. *Id.*

700. *Id.* at 14,754–55.

701. *Id.* at 14,756.

702. *See, e.g.*, *P.R. Tel. Auth. & GTE Holdings*, 14 F.C.C.R. at 3130–31; *Pac. Telesis Group*, 12 F.C.C.R. at 2636–38.

703. *See* United States v. SBC Communications, Inc., 1999-2 Trade Cas. (CCH) ¶ 72,631 (D.D.C. 1999).

704. *Id.* at 85,684.

705. The FCC placed a number of conditions on the transaction including: (1) providing nondiscriminatory access to competitors for advanced telecommunications services, such as DSL; (2) making various aspects of its local wireline network available to competitors; (3) promising to enter wireline markets outside of the merged firm's

4. THE BANKING INDUSTRY

The banking industry represents another sector of the economy that is subject to an extensive web of federal and state regulations. The Board of Governors of the Federal Reserve System ("the Board") oversees most large banking mergers and acquisitions.[706] The decisions are binding, subject to federal court review of the Board's decisions.[707] The DOJ can also challenge the Board's determination.[708] The federal law governing the review of such transactions is similar to the language of section 7, barring, among other things, the Board from approving any merger or acquisition "whose effect . . . may be substantially to lessen competition" unless the transaction's anticompetitive effects are "clearly outweighed" by "the convenience and needs of the community to be served."[709] Because section 7 is a guide, it should be no surprise that the potential competition concept has been raised.

However, the lesson of the cases suggests that a regulated environment alters the applicability of the doctrines. Regulation may artificially constrain the number of potential entrants[710] or prevent entry altogether.[711] The Supreme Court explored this issue in *Marine Bancorporation*, finding that a firm was not a potential entrant because the state banking regulations prevented it from entering the market.[712]

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territory; (4) improving residential phone service to its existing customers; and (5) creating a self-enforcing compliance plan. *See Ameritech & SBC Communications*, 14 F.C.C.R. at 14,859-86.

706. The Board of Governors of the Federal Reserve System ("the Board") has oversight authority over many banking mergers, including mergers between bank holding companies. Other agencies, such as the Office of the Comptroller of the Currency, oversee certain types of transactions depending on how the merger applicant is chartered. Thus, a merger between bank holding companies is likely to be reviewed by a different body than one between savings associations. In many instances, regulators are able to grant antitrust immunity to the transactions. *See* 12 U.S.C. §§ 1467(e)(2), 1821(n), 1828b(c), 1842-1843 (2000).

707. *See, e.g.*, *id.* § 1828(c)(7).

708. There is some controversy over whether state attorneys general may also participate in such proceedings. For a review of the two opposing views, see J. Robert Kramer II, *Antitrust Review in Banking and Defense*, 11 GEO. MASON L. REV. 111, 116 n.26 (2002) (citing to articles that discuss each viewpoint).

709. 12 U.S.C. § 1842(c)(1)(B). The statute also precludes the Board from approving transactions that "tend to create a monopoly" or are "in restraint [of] trade." *Id.*

710. *See, e.g.*, *Mercantile Tex.*, 638 F.2d at 1267.

711. Courts have also observed that regulation also shifts how firms compete in the banking sector. *See, e.g.*, *id.* at 1264 & n.12.

712. 418 U.S. at 629-30; *see also* United States v. United Va. Bankshares Inc., 347 F. Supp. 891, 893-94 (E.D. Va. 1972).

In *United States v. Citizens & Southern National Bank*, Georgia's banking laws prohibited banks from branching through internal expansion.[713] During this era of state regulation, a bank's only option for expansion was by entering into an affiliation with another bank.[714] The bank could also hold as much as 5% of the affiliate's stock.[715] Citizens & Southern National Bank ("C&S") created such affiliates.[716] The government alleged this arrangement violated section 7, in part, because the affiliate system prevented the branch banks from later competing against C&S.[717] It similarly argued that the arrangement was illegal under section 1 of the Sherman Act.[718]

The Court rejected these theories.[719] As it explained when it addressed the Sherman Act claim: "To characterize these relationships as an unreasonable restraint of trade is to forget that their whole purpose and effect were to *defeat* a restraint of trade. Georgia's antibranching law amounted to a compulsory market division."[720] Since the arrangement was well-established, the potential competition theories in the case were weak. As the Court noted, while the affiliated banks were independently owned and could theoretically break their affiliation, the affiliated banks found their relationship profitable and management was not interested in changing course.[721]

Alternatively, state efforts to deregulate by lifting entry barriers opened the door to a large number of candidates that could enter the market, thwarting a claim that a transaction could violate the potential competition doctrine.[722] For example, New Jersey placed restrictions on a bank's ability to open branch offices in a county, unless the bank's headquarters were located in that county and only then when no other bank was headquartered in the same county.[723] A district court observed that under this state of regulation, "most banking markets within New Jersey were artificially concentrated and non-competitive."[724] Once these restrictions were lifted, banking competition increased and the number of potential entrants into the market increased as well, making the potential competition doctrine less relevant.[725]

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713. 422 U.S. 86, 89 (1975).
714. *See id.*
715. *See id.*
716. *Id.*
717. *Id.* at 101–02.
718. *Id.* at 100–01.
719. *See id.* at 119–22.
720. *Id.* at 118.
721. *Id.* at 121–22.
722. *See, e.g.*, United States v. First Nat'l State Bancorporation, 499 F. Supp. 793, 798, 814 (D.N.J. 1980).
723. *Id.* at 798.
724. *Id.*
725. *Id.* at 814.

5. THE RAILROAD INDUSTRY

The Surface Transportation Board ("the Transportation Board") oversees and reviews railroad mergers.[726] Unlike enforcement agencies in many other industries directly subject to the antitrust laws, the Transportation Board has exclusive jurisdiction in its review, [727] but periodically uses the antitrust laws to inform its decisions.[728] The Transportation Board has recognized the importance of potential competition in cases involving shipper build-out threats.[729] The build-out threat is essentially a threat to enter the market in competition with the monopolist railroad and thereby constrain shipping rates.[730]

Often, shippers rely on one railroad's tracks to provide service to its plant. In the absence of any agreements to allow rivals access to those tracks, the shipper may be captive to that railroad's service even though a competitive alternative may connect with that railroad only a few miles from the shipper's plant.

If a shipper's demands are large enough, it could be feasible for the shipper to construct its own line with the nonconnecting railroad and act as a check to keep railroad rates competitive. This constraint is eliminated if the monopolist railroad merged with the nonconnecting line. While the Transportation Board has often approved mergers between such railroads, it has made efforts to preserve the build-out threat by granting operating rights to other railroads over the relevant portion of the nonconnecting railroad's tracks.[731]

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726. *See* 49 U.S.C. § 11324; 49 C.F.R. § 1180.1 (2003). Like the FCC, the Surface Transportation Board uses a "public interest" standard to review mergers and other transactions. *See* 49 U.S.C. § 11324(c); 49 C.F.R. § 1180.1(c).

727. *See* 49 U.S.C. § 11321(a); *see also* McLean Trucking Co. v. United States, 321 U.S. 67, 87–88 (1944) ("The wisdom and experience of [the] commission, not of the courts, must determine whether proposed consolidation is 'consistent with the public interest.'").

728. Competition is one aspect of the agency's public interest standard of review. *See* 49 U.S.C. § 11324(b)(5), (c); 49 C.F.R. § 1180.1(c)(i).

729. *See* CSX Corp. & CSX Transp., Inc., 3 S.T.B. 196, 260 (1998).

730. *See id.*

731. *See id.* (discussing the remedy to preserve a build-out threat for Joseph Smith and Sons); Union Pac. Corp.—Control & Merger—S. Pac. Rail Corp., 1 S.T.B. 233, 371–73, 420 (1996) (discussing the private agreement between the Chemical Manufactures Association and the merging parties to protect build-out threats for chemical shippers); Burlington N. Inc.—Control & Merger—Santa Fe Pac. Corp., 10 I.C.C.2d 661, 744-45, 781 (1995) (preserving build-out threats for Oklahoma Gas and Electric and for Phillips Petroleum).

III. RETHINKING POTENTIAL COMPETITION: A NEW APPROACH

We have now surveyed the expanse of case law and regulatory approaches to the concept of potential competition. Throughout our discussion, we have noted the flaws of the conventional approaches to this concept. In this Part, we present a unified critique and consider the observations of commentators. Following this discussion we will present a superior approach that resolves the current confused state of potential competition in antitrust cases.

A. *The Cases: Falling Short of a Rational Approach*

The discussion above leaves potential competition wanting a rational and consistent approach. Specifically, there are numerous inconsistencies within the section 7 analysis of potential competition that make the doctrine difficult to apply in varying contexts. Moreover, the section 7 potential competition doctrine is at odds with the doctrine as it is applied in section 1 and 2 cases. And, even within the context of the Sherman Act, the doctrine is inconsistently applied.

The sources of the inconsistencies are many. To summarize, they are: (1) the various roles that potential competitors play in each type of case; (2) the standard of proof needed to allege that the potential entrant is or is not disciplining the market; (3) what weight to give competing subjective and objective evidence of intent and ability to enter; (4) how a court should interpret evidence of successful entry in other markets or repeated attempts at entry in the market in question; (5) the degree to which the market is expanding or contracting, and the role the expansion or contraction plays in the analysis; (6) the degree to which (de)regulation precludes or encourages entry; (7) linear application of market definitions without regard for the conduct alleged; and (8) the weight of evidence of the perception of incumbents that the potential entrant will enter.

One source of confusion is the notion that the potential entrant plays different roles depending upon the type of case brought. For example, a potential entrant may play numerous roles in a case—it could be the acquired company, the acquiring company, the monopolist, a component of market definition or a firm that mitigates the anticompetitive effects of a merger or monopolizing conduct via entry. In short, the perspective the courts take on the anticompetitive harm should, as a component, consider the role of the potential competitor in relation to the transaction. While in section 7 cases the potential competitor is typically the acquiring firm, it need not always be. In the context of section 2 cases, the potential competitor defines the extent of the relevant market and whether the conduct of the monopolist will be mitigated by entry. And, in section 1 cases, the potential competitor determines whether the contracting party (or coconspirator) are in a horizontal relationship, giving rise to per se analysis, or whether the coconspirators are in a vertical relationship, giving rise to the rule of reason analysis. By not consciously distinguishing between the various roles that potential competitors play, courts applying the doctrine are left without sufficient guidelines, and more importantly, are left to make determinations of liability on an ad hoc basis.

Even if the role of the potential competitor were clearly established by the courts at the outset of each case, the court's analysis would be far from crystal clear. This is because the courts tend to apply different standards of proof upon plaintiffs asserting or defending against a potential competition issue. In the context of the actual potential competition doctrine in section 7 cases, while proving that the acquiring firm would likely enter the market but for the transaction, the plaintiff may face a "clear proof"[732] or "reasonable probability standard."[733]

Alternatively, the plaintiff may have to prove that the potential competitor "would likely" enter the market, depending upon the circuit in which the case is filed.[734] In the context of section 1 cases, the potential competitor must have some "intent and ability" to enter, although it is not clear to what degree that must be proven. And, in the context of section 2 cases, plaintiffs and defendants fall into a potential competitor trap, where proving the existence of potential competition (to whatever degree is required) might simultaneously be required to make the plaintiff victorious and a sufficient basis upon which to dismiss the claim.[735]

Another significant difficulty in the cases is how a court reconciles objective and subjective evidence. In many cases, court demands for various forms of objective evidence, such as determining the opportunity cost of entry, are often meaningless without other forms of subjective evidence.[736] For example, even if entering a market were highly

732. *See, e.g.*, *Atl. Richfield*, 549 F.2d at 294–95; *see also* Reazin v. Blue Cross & Blue Shield of Kan., Inc., 663 F. Supp. 1360, 1490 (D. Kan. 1987) (stating that "clear proof" is required), *aff'd in part & remanded in part*, 899 F.2d 951 (10th Cir. 1990). Many commentators have observed that these high evidentiary hurdles were at least partly responsible for curtailing such actions. *See* HOVENKAMP, *supra* note 3, § 13.4b; SULLIVAN & GRIMES, *supra* note 26, § 11.3b1–.3b3; Brodley, *supra* note 391, at 377–80; Kwoka, *supra* note 392, at 178.

733. *Mercantile Tex.*, 638 F.2d at 1268–69. This standard within the Fifth Circuit requires some analysis of opportunity cost or whether the acquiring firm "would prefer the opportunity to enter [the relevant market] over other opportunities for expansion or investment." *See id.* at 1269.

734. *See, e.g.*, *Tenneco*, 689 F.2d at 352.

735. *See supra* Part II.D.

736. *Mercantile Tex.*, 638 F.2d 1268–69.

profitable to a firm with extensive resources and experience in a similar industry, other qualitative considerations should tip the scale of whether a firm is an entrant.

A related problem with the cases that also illustrates the default of relying on objective evidence is the degree to which evidence of successful entry elsewhere or evidence of past failed attempts at entry should be persuasive of the ability to enter into a relevant market has been interpreted in a nonuniform fashion by the courts. A potential entrant who has failed numerous times in the past to enter a market demonstrates strong subjective intent to enter, but a weak objective expression of ability to enter. To what degree should the subjective be weighed against the objective? It may be the case that the potential entrant, defeated, has sought a nonindependent means of entry. Alternatively, it might be a matter of time before the entrant finally enters de novo. The courts have lacked a clear expression of how to distinguish the two circumstances. The problem is exacerbated in the context of monopolization cases when it is the monopolist's conduct that to some degree contributes to the potential entrants inability to enter de novo. Grasping at straws in order to make such determinations, courts have looked to whether potential entrants have successfully entered *other* markets after failed attempts, even where such markets are not similar to the markets in question in the case.

One potential gauge of how to weigh such evidence might be the degree to which the market in question is expanding or contracting. However, such a gauge may not prove very fruitful. Contracting markets are typically subject to concentration and problems of attracting sufficient demand to meet supply. In such markets, potential competitors are less likely to play a substantial role: only a crazy person climbs aboard a sinking ship. However, given a limited number of competitors, potential entry may discipline a relatively concentrated market should the incumbents elect to raise price, even if the market is consolidating.

In contrast, if the market is expanding rapidly and demand is outstripping supply, potential entrants play a major role in disciplining price. However, in such an instance, potential entrants may be like barbarians at the gates—a horde of potential entrants lining up to take their share of the market. Thus, it is unclear whether the market's growth or consolidation offers much that is useful. Courts have used market conditions as a justification for their findings without articulating standards: courts have inferred the significance of potential competitors from both shrinking and expanding markets. In many other instances, the courts do not address the state of the market at all. Regardless, the nuances of the market and the industry in question ought to be considered by the court.

Another aspect that separates the potential competition cases is the degree to which (de)regulation should play a role in the analysis. Regulation and deregulation should be two sides of the same coin in antitrust analysis. Yet, courts have analyzed these phenomena differently in the banking and energy industries. Regulatory barriers that prevent de novo entry of a firm in the same industry into a nearby territory sound the death knell for any claim that a firm is a potential competitor. But, the removal of regulatory barriers is insufficient evidence that the two companies may be in competition. The structure of regulation seems certain due to the timelessness of the governing regulations and statutes, yet the passage of statutes fostering competition is too speculative a basis upon which to hang the potential entrant hat. And, even in instances where competition is looming, courts are blind to such facts and presume that the potential competitors are engaging in a merger or acquisition, for example, on a seemingly conglomerate basis.

Another sticky wicket is the relationship between the alleged conduct, the definition of the market and market power, and the burden of proof necessary to show whether a firm is a potential competitor. Typically, there is a relationship between the degree of market power alleged to be held by the defendant and the nature of the conduct being alleged: the greater the degree of market power, the less egregious the conduct need be. And, in that relationship, a defendant's burden to identify potential competitors as a defense becomes more onerous. Similarly, in cases where an antitrust defendant has a lower market share, more aggravating conduct must be found by a court to sustain a claim. As the conduct becomes egregious, potential competition becomes less relevant as a defense. In the context of section 1, for cases involving price fixing, no market is alleged—although one is implied. Instead, it is the agreement that governs the relationship between the two coconspirators or parties to the contract, which is the violation itself.

In all but the per se section 1 cases, the courts have appeared to have abandoned this antitrust proposition. The high level of market share that AA held over certain city pairs should have established a presumption of liability. It would be AA's burden to show mitigation via potential entry under such circumstances, not the government's. On the other hand, if the conduct is not particularly egregious (for example, a merger between potential entrants in a consolidating market), the burden would be on the government to show the anticompetitive effects of the transaction. While historically this approach has been the norm in antitrust litigation, it has, in recent years, been all but forgotten, particularly by courts applying the potential competition doctrine.

Another difficulty occurs when the alleged conduct arises out of a perception that the targeted firm is a potential entrant. There are three components to this difficulty: proof of the perceived potential competition doctrine; proof that the conduct alleged arises from fear of the potential competitor; and, finally, proof that the perception that others are waiting in the wings will discipline price.

With respect to the first issue, it is exceptionally difficult to prove "perception." The problem is in the objective evidence of a subjective feeling that the outside firm is disciplining incumbents. Self-serving memos may abound from excessively paranoid marketing agents, for example. An additional trick is the difficulty of demonstrating that the incumbent altered its competitive behavior in light of perceived entry. Was the competitive pricing response a response to the perception that entry would take place, or a response to actions by incumbents? It is not always clear, especially when price movements by incumbents overlap with some evidence of perception about potential entry. There is also the issue as to during what time period the perception is relevant. As Professor Joseph F. Brodley indicates, "it would be unlikely that the perception, if it occurred, came at once with full force, or at the same time for all inside firms."[737]

A second issue is the difficulty of proving that the perceived potential competitor is the underlying basis for the conduct alleged—that is, that an incumbent monopolist might engage in pricing decisions on the basis of the perception that potential competitors are waiting in the wings. For example, AA engaged in certain pricing decisions after mere announcements of entry by its LCC competitors—long before there was any competitive effect stemming from actual entry. There is little justification here that the response was a competitive one arising from competitive conditions in the market. On the other hand, some pricing actions were undertaken after the LCCs entered and announced fares and flights. In these instances, perhaps the perception of entry did indeed cause prices to fall for legitimate reasons apart from predatory pricing. At the very least, it would be an issue of fact resolved at trial.

A third issue is whether the perception that competitors are waiting in the wings will discipline price. For example, Microsoft alleged that potential competitors were the underlying basis for its pricing decisions and therefore should be included in the relevant market—a claim wisely ignored by the Court due to a lack of objective or even subjective evidence supporting such a contention. Nonetheless, courts have not had the opportunity to fully articulate a vision as to how a perceived potential competitor case might look in the absence of actual potential competition.[738]

737. Brodley, *supra* note 391, at 380.

738. In only three cases have mergers been found to be unlawful under this theory, all of which were also based upon actual potential competition theory, one of which was reversed. *See Tenneco*, 689 F.2d at 355 (reversing the FTC's conclusion that Tenneco's acquisition of another company "violated § 7 by eliminating Tenneco as a

In sum, the courts have lacked a single, uniform vision of how potential competition ought to be treated in its various possible roles in section 1, 2, and 7 cases. A lack of a test that combines the objective and subjective elements necessary to handle this complicated issue, along with a lack of sophistication as to the presumptions and burdens of proof in such cases, has led to the death of the potential competition doctrine at a time where it is desperately needed.

The Guidelines, in their various incarnations, offered some relief from the plethora of analyses offered by the courts. However, several defects limit the Guidelines' usefulness with respect to potential competition doctrine.

The 1984 Guidelines, by practical and theoretical considerations, are limited in usefulness. First, it is generally accepted that the 1984 Guidelines have been all but revoked by the enforcement agencies. The likely reason for this is that the enforcement agencies now view non-horizontal mergers in terms of horizontal effects. In other words, any trouble arising from the exercise in vertical market power is likely the result of an exercise in horizontal market power. A second limitation in the 1984 Guidelines is their poorly articulated views on entry. As one pair of commentators has noted, the 1984 Guidelines "were extremely skimpy with respect to 'ease of entry,' limiting discussion to barely more than one sentence and a footnote."[739]

The 1984 Guidelines also suffered from a tendency to restate the common law on potential competition. For example, the 1984 Guidelines noted that potential competition concerns could arise in the context of "perceived" or "actual" potential competitors.[740] The 1984 Guidelines simultaneously considered potential competition mergers as "non-horizontal" while applying horizontal analysis to them.[741] Specifically, the 1984 Guidelines examined the relevant market, entry barriers, and whether the acquiring firm had a unique entry advantage.[742] In short, the 1984 Guidelines examined aspects already entrenched in the common law, with little guidance as to how they should be applied, and all of the issues raised above with respect to the

potential competitor"); *Phillips Petroleum*, 367 F. Supp. at 1254–56, *aff'd without op.*, 418 U.S. 906 (1974) (finding that Phillips's entry from the edge of the market through acquisition of another company violated section 7 by eliminating procompetitive effects); *In re* Brunswick Corp., 94 F.T.C. 1174, 1254 (1979), *aff'd in part and rev'd in part sub. nom. Yamaha Motor*, 657 F.2d 971 (finding that the joint venture lessened actual and potential competition).

739. Gary L. Reback & Christopher O.B. Wright, *Government Antitrust Review of High Technology Mergers*, 9 COMPUTER LAW., June 1992, at 1, 5.

740. 1984 GUIDELINES, *supra* note 150, § 4.12–.13.

741. *Id.* § 4.0, .13.

742. *Id.* § 4.131–.133.

common law treatment of potential competition are applicable to the 1984 Guidelines as well.

The 1992 Guidelines fare no better, and perhaps fare worse, than the abandoned 1984 Guidelines. The 1992 Guidelines, as stated above, make great strides in examining issues of entry. However, the 1992 Guidelines' entry analysis is limited in its applicability with respect to certain industries, particularly regulated industries. For example, under a 1992 Guidelines analysis, a merger between two regulated electric utilities in neighboring service territories might be allowed (assuming no wholesale market power effects), even if the state in which the two utilities reside is opening its markets to retail competition in three years.[743] Thus, the Pennsylvania cases discussed above would still turn out poorly under a 1992 Guidelines analysis, should the entry factors of the 1992 Guidelines be slavishly applied.

In addition to the limited use of its entry analysis, the 1992 Guidelines also suffer from the lack of serious attention given to potential competition issues. Apart from incorporating by reference a statement indicating that the 1984 Guidelines analysis of potential competition lives, if only in spirit,[744] the 1992 Guidelines also discuss uncommitted entrants. Uncommitted entrants are firms not producing or selling in the relevant market that could produce or sell in that market in one year or less in response to a significant and nontransitory increase in price.[745] The uncommitted entrant is included in the market share calculation based upon capacity or some forecast of sales.[746]

Professor John E. Kwoka has discussed several limitations of this approach. First, the 1992 Guidelines do not view the subjective beliefs of the incumbent with respect to the entrant, thus ignoring "'[p]erceived potential competition'" and subjective criteria.[747] Second, the one-year response time is a bit arbitrary, and does not consider whether the industry typically has a larger response time or whether there is a statutory barrier that limits competition from taking place within one year.[748] Third, the market calculation of an uncommitted entrant's share is tricky, even with respect to capacity, and may not give much insight as to the anticompetitive effects of the transaction in question.[749] In

743. The 1992 Guidelines would not view such entry as timely, and there may be serious questions as how to gauge likelihood and timeliness. *See* 1992 GUIDELINES, *supra* note 352, § 3.2-.4.

744. *See* DOJ & FTC STATEMENT, *supra* note 355, at 22 ("Neither agency has changed its policy with respect to non-horizontal mergers.").

745. 1992 GUIDELINES, *supra* note 352, § 1.32.

746. *Id.* § 1.32 & n.13.

747. *See* Kwoka, *supra* note 392, at 182.

748. *Id.*

749. *See id.*

short, the 1992 Guidelines appear to be a blunt instrument in an area that requires finesse.

B. The Leading Scholars: Falling Short of a Unified Approach

Many leading academics have attempted to develop their own approaches to this confusing area of law. We examine these attempts in turn. It should be noted at the outset that we are generally sympathetic to these attempts. However, the one common problem of each approach is that they fail to take into account the role potential entry plays in Sherman Act actions, and focus singularly on section 7 of the Clayton Act. Of course, this is an unfair criticism, as most scholars have not addressed the potential competition aspects of sections 1 and 2 of the Sherman Act.

To begin, Brodley, in his article *Potential Competition Under the Merger Guidelines*, examines how examination of the major potential competition cases would take place under the *1982 Merger Guidelines* ("1982 Guidelines").[750] Brodley argues that the 1982 Guidelines are generally sympathetic to potential competition issues because they "simplify previous analytic approaches."[751] The 1982 Guidelines examined, in the first instance, "four key structural criteria: market concentration, entry conditions, the acquiring firm's relative entry advantage, and the target firm's market share."[752] However, the 1982 Guidelines were ambiguous as to what was meant by entry advantage. Brodley takes the concept of market proximity to plug this gap:

> Two markets are proximate to the extent that a knowledgeable firm in one market possesses the necessary production and marketing information and other capabilities to operate in the other. Market proximity provides a suitable surrogate for entry advantage because, other factors being equal, there is less risk and therefore less expense involved in entering a familiar market. . . . Proximity is determined by: (1) the similarity between the two markets in terms of critical entry characteristics, such as production, marketing, technology, and transactional relations; and (2) actual observed entry between the two markets, or from the outside market into a market closely similar to the inside market. If according to these criteria the proximity between markets is close, it can be presumed that the acquiring firm has an entry advantage.[753]

750. Brodley, *supra* note 391.
751. *Id.* at 401.
752. *Id.* at 387.
753. *Id.* at 391-92 (footnotes omitted).

The approach Brodley espoused is quite sophisticated and purports to be a strictly objective test based "on presently existing facts" and not based upon a "hazardous assessment of future cost or demand."[754]

There are two major defects in Brodley's approach. First, Brodley's examination is limited to potential competition issues arising from mergers and does not address section 1 and 2 potential entry issues. It is not clear that the test Brodley espouses would work well in these confines. For example, if one were to take the issue of potential entry in the airline context described above, it would seem perfectly reasonable to assert that airlines that control hubs might enter nonhub markets.[755] More specifically, in the context of the AA case, it would be a reasonable assertion that United Airlines ("United") might add a nonstop route between Wichita and DFW. After all, airline routes are similar in nature—and United may have established such a route in the past (perhaps in retaliation for AA's action elsewhere). Thus, under Brodley's test, one might obtain perverse results with respect to a defensive use of the doctrine, such that a defendant could suggest much broader markets where no competition has existed before and may never in fact exist.

A second defect is that Brodley's test, insofar as it relies on the 1982 Guidelines, suffers from the defects inherent in the 1982 Guidelines. Thus, perverse results may be obtained if the 1982 Guidelines are slavishly applied (despite their caution against such rigid application) to deregulating markets where no competition currently exists. In such markets, slavish application of the 1982 Guidelines might clear mergers that are likely to lead to the downfall of the market about to be opened to competition.

Kwoka has proposed another test.[756] Kwoka's approach has two components: "(1) satisfaction of one structural precondition for concern with mergers involving non-incumbent firms, and then (2) demonstration of certain features specific to the case of (a) a deconstraining merger or (b) an entry-negating merger."[757]

The first step, demonstration of a structural precondition, looks to whether there is moderate concentration of a market according to the 1992 Guidelines. As discussed below, as a practical matter cases are not brought unless markets are at least moderately concentrated if not significantly so. Thus, the first step is a step in any merger action (or monopolization action, for that matter), and fails to add much to the

754. *Id.* at 392.
755. *See supra* Part II.E.2.
756. Kwoka, *supra* note 392.
757. *Id.* at 198.

analysis. And, in the case of section 1 per se cases, market concentration may not be required at all.

Under Kwoka's test, if the precondition holds, then the analysis is bifurcated and depends upon whether the potential competition merger is entry-negating or deconstraining. If the former, then Kwoka suggests that the transaction "would be challenged on the basis of convincing evidence that the firm represented an effective and significant constraint on competition among incumbents."[758] Convincing evidence would include "documents in the possession of incumbent firms indicating active monitoring of and reaction to the non-incumbent party to the merger" or "market data that demonstrate significant responsiveness by incumbents to actions of the allegedly constraining firm."[759]

This aspect of Kwoka's test is appealing insofar as it examines both subjective and objective factors to determine entry. Thus, we are not troubled by this portion of Kwoka's test and to some degree incorporate portions of this component into our own test.

With respect to an entry negating merger, Kwoka would have the enforcement agencies challenge such transactions if:

> (1) The non-incumbent competitor has the capability to enter within a period of two years.
>
> (2) The non-incumbent competitor would likely find entry profitable if price were to remain at its present level (or rise by some predictable amount).
>
> (3) The non-incumbent competitor could enter at a scale sufficient to reduce price by a small but significant and nontransitory amount (or hold it constant if it otherwise would rise by at least a small but significant amount), or could enter at a smaller initial scale but with the capability and incentive to expand substantially within a period of two years.
>
> (4) The non-incumbent competitor is one of no more than five equally well-positioned prospective entrants, or is significantly better positioned to enter than any other possible entrant. As noted earlier, in the presence of many equally well-positioned non-incumbents, the elimination of a single one would arguably not affect future market performance.[760]

Presumably, although it is not explicit, all of these conditions must hold simultaneously for there to be a problem under Kwoka's analysis. These factors are, however, at first blush, directed at two things: intent and ability to enter. To that extent, we find no difficulty with Kwoka's

758. *Id.* at 200.
759. *Id.*
760. *Id.* at 199.

analysis, particularly his reliance upon "documentary evidence" and "objective facts" for such determinations.[761]

The problem here is that Kwoka ignores the many roles that potential competitors play in merger cases. While his analysis may be useful if the sole role of the potential competitor is as one of the merging parties, potential competitors play other roles as well. So, under Kwoka's analysis, in a section 2 case against AA for predatory pricing and capacity responses in the DFW-Wichita route, United may well be a market-deconcentrating potential competitor.

Under Kwoka's analysis, United might be considered a nonincumbent competitor in the DFW-Wichita route, since it does not provide such service in that route. Moreover, it might find entry profitable, and could even enter on a sufficient scale to reduce prices. However, United would be unlikely to enter such a route (it is a nonhub route, and there might be retaliation by AA). It might even be one of no more than five equally positioned competitors. Thus, use of Kwoka's test in the context of nonmerger cases might lead to perverse results.

C. *A New Approach*

Although it is easy to tear something apart, it is perhaps more difficult to create something from the shreds. As we walk into the minefield of something as complex as potential competition, we tread carefully. To begin our discussion, we start with five guiding principles regarding how to analyze potential competitors in our effort to build a new test.

First, while many of the cases have emphasized the prominence of entry barriers and the need for a highly concentrated market before the potential competition concept or entry becomes relevant, we wish to deemphasize these factors as unique to a "potential competition" case. Virtually all of the modern antitrust cases—except for the section 1 cases alleging per se antitrust violations—require high entry barriers and a concentrated market for a plaintiff to prevail.[762]

761. *Id.* at 199-200.

762. *See, e.g.*, *Microsoft*, 253 F.3d at 54-56 (finding a 95% market share and significant entry barriers into the relevant market); *H.J. Heinz*, 246 F.3d at 711, 717 (finding a highly concentrated market where merged firm would have approximately 33% of the market and largest competitor had 65% of the baby food market and where entry barriers are high); *Visa U.S.A.*, 163 F. Supp. 2d at 341-42 (finding that Visa and Mastercard controlled 85% of all credit cards issued and 73% of all general credit card transaction volumes and there were high entry barriers into the relevant market); FTC v. Swedish Match, 131 F. Supp. 2d 151, 166, 170-71 (D.D.C. 2000) (finding entry barriers were high in a concentrated market where two merging firms would have 60% of the relevant market and with the next largest competitor having over 30% of the market).

No section 7 violation occurs when two competitors in a market merge if literally anyone can enter the market and each entrant can have a similar impact on the market. Similarly, no violation occurs when a dozen other firms, each of a similar size, are already in the market. Similarly, in a rule of reason case examining the anticompetitive effects of a restraint, the harm is likely to be small if numerous competitors are in the market or can enter on a moment's notice and have the same impact as the incumbents without incurring substantial sunk costs. Thus, there should be no "extra" requirement that markets involving potential competitors be even more concentrated or entry barriers be even higher than the garden-variety antitrust case.

Second, at its core, regardless of the antitrust violation, potential competition claims involve essentially identical issues. In evaluating a monopolization claim in which a firm enters exclusive contracts with distributors to keep would-be competitors out or whether an incumbent firm enters a restrictive contract with a would-be rival, a court is scouring the record to answer the same two questions: how likely is it that the would-be entrant would become a competitor, and how much of an impact was the firm having in the wings? However incoherent the section 1 and 2 cases are and however strange a court's analysis of them may be, ultimately, these two issues are the relevant ones to an antitrust analysis. Thankfully, the section 7 cases are a bit more explicit in these inquiries. As a result, it is only rational to apply the same standards to the same inquiries, regardless of whether the violation is dressed as a section 1 or 2 of the Sherman Act claim or section 7 of the Clayton Act claim.

Third, as an analog to our second point, it should be apparent that the same issues of potential competition apply for a defendant who argues that potential entry nullifies any anticompetitive effects as for a plaintiff who wishes to show that a defendant's conduct is eliminating a potential rival. When a defendant raises the existence of potential entry, it is an affirmative defense and one that is raised in light of a plaintiff's showing that a market is highly concentrated and that entry barriers are substantial. Thus, the same standards of proving potential entry are applicable to defendants and plaintiffs. To conclude otherwise would be illogical, providing a distinct advantage to defendants who can speculate as they wish about entry while plaintiffs must, with greater certitude, show that a firm *will* enter the market or that it *is* currently constraining prices by some precise amount.

The only possible imbalance we see is to accommodate the per se section 1 cases. In these situations, such as price-fixing between horizontal competitors, the defense should not be able to assert that potential competition will negate the effects of the agreement. Courts have concluded that no efficiency justification exists for such agreements.[763] Thus, a court should not waste its time trying to determine whether the agreement is benign because it achieves no legitimate business purpose.

It is important to pause at this stage before moving to our next observation to consider why we appeal for uniformity in the application of concepts related to potential competition. The consistent and logical application of potential competition principles in the long-run enhances the prevailing objective of antitrust: preserving consumer welfare by preserving current and future competition.[764] Courts that have underemphasized or overemphasized the presence of potential competitors have done so to the detriment of consumers.[765] But, if one steps away from the cases and seeks simply to analyze a market as an economist might, a consistent approach to potential competition is desirable. For example, in the merger context, an economic analysis of an antitrust market that includes a firm that is 50% likely to enter that market should reach the same conclusion on the effect that firm may play in the market, regardless of whether the firm is the target of the acquisition or unassociated with the transaction and viewed as a potential entrant.

Consistency also provides other ancillary benefits. A consistent application of potential competition in the cases would raise the transaction costs of would-be antitrust violators who more clearly

763. In *The Antitrust Paradox*, Bork suggested that the per se approach should be scaled back from its application for fear that otherwise efficient conduct was excluded within an otherwise competitively benign arrangement. *See* BORK, *supra* note 39, at 267–77. We do not comment here on the proper scope of per se rules in antitrust law, we only observe that to the extent courts use them, our approach should be followed.

764. *See, e.g.*, AREEDA & HOVENKAMP, *supra* note 4, at ¶ 100 ("[T]he principal objective of antitrust is to maximize consumer welfare by encouraging firms to behave competitively."); BORK, *supra* note 39, at 51; Fred S. McChesney, *Talking 'Bout My Antitrust Generation: Competition for and in the Field of Competition Law*, 52 EMORY L.J. 1401 (2003); *In re* Am. Med. Int'l, 104 F.T.C. 180, 204-05 (1984) ("[E]ven assuming that the limited price competition that does exist in these markets may produce only marginal benefits in terms of consumer welfare, the antitrust laws will endeavor to protect this price competition, if, for nothing else, the hope that price competition will be enhanced."). The Supreme Court is also a believer in this view. *See, e.g.*, NCAA v. Bd. of Regents, 468 U.S. 85, 107 (describing antitrust law as a "consumer welfare prescription").

Notably, even from a purely economic view, the consumer welfare model of antitrust that emphasizes competition may not always achieve welfare enhancing or desirable results, especially when externalities exist. For example, it may be desirable for cigarette companies to collude and raise prices or polluters to collude. *See, e.g.*, Jonathan H. Adler, *Conservation Through Collusion: Antitrust as an Obstacle to Marine Resource Conservation*, 61 WASH. & LEE L. REV. 3, 56–58 (2004) (discussing how polluters can collude).

765. One explanation for the inconsistencies, which generally seem to favor antitrust defendants, is simply that courts are skeptical of antitrust enforcement for fear of impeding commerce. Nonetheless, the current approach is a convoluted expression of that skepticism that provides opportunities for mischief.

become exposed to antitrust liability[766] while setting a clearer standard to exonerate legitimate business behavior.[767] And, clearer rules provide less room for misapplication and abuse—at least if those rules reach results that preserve consumer welfare.[768]

Our fourth observation is that although the courts have made an effort to seek "objective" evidence in order to make determinations of potential entry, we believe that this approach is naïve. As we have seen, objective criteria, such as past failed entry attempts, the attractiveness of a market, and others, can be construed in different ways.[769] Furthermore, there is great subjectivity hiding behind many of these "objective" tests. For example, the Fifth Circuit's opportunity cost approach is one that involves a number of assumptions and discretionary decisions in order to reach a result.[770] And, that is without considering the criticisms leveled at this approach in other applications, such as predatory pricing.[771]

Instead, a more reasoned approach to determine whether potential entry is relevant would be to include an examination of internal documents, trade industry information, and the testimony of knowledgeable individuals. This evidence may offer valuable insight into determining motives or helping explain how the "objective" facts lead to a particular conclusion. Even though such evidence could create incentives for firms to generate documents favorable to their ultimate litigation position, we believe such manipulation is difficult for at least two reasons.

First, many business communications are spontaneous, like e-mails, and reflect responses to issues that may often not obviously implicate antitrust liability. How does one "cover the tracks" on the perceived anticompetitive effects of a proposed merger two years before the

766. *See* Christopher R. Leslie, *Trust, Distrust, and Antitrust*, 82 TEX. L. REV. 515, 622–31 (2004) (noting that the risk of per se antitrust exposure raises transaction costs for would-be price fixers).

767. Clearer competition rules channel business behavior, discouraging certain relationships or transactions. *See, e.g.*, Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 801–06 (1941) (introducing the concept of channeling with respect to contract law). This channeling function can be desirable to avoid both the transaction costs associated with a lengthy antitrust review and litigation, while also more swiftly avoiding anticompetitive effects.

768. *See* Paul L. Joskow, *Transaction Cost Economics, Antitrust Rules, and Remedies*, 18 J.L. ECON. & ORG. 95, 111–12 (2002).

769. *See supra* note 737 and discussion in accompanying text. We are not the first to observe this criticism, however. As Hovenkamp explained, "[i]t strains credulity to think that courts can reliably make findings of likelihood of entry based on this [objective] kind of evidence." HOVENKAMP, *supra* note 3, § 13.4b.

770. *See supra* notes 224–28 and accompanying text; *see also* HOVENKAMP, *supra* note 3, § 13.4b.

771. *See supra* note 230.

merger has been announced and before anyone in management ever contemplated it? And, such a strategy to misrepresent a firm's actual intentions may backfire if the firm finds itself in the situation of being an antitrust plaintiff.

Second, misleading documentation creates significant communications costs on the firm. Employees may misinterpret the information. To avoid miscommunication, a firm must be willing to spend time and resources to create a code for its competitive issues or explain to employees which documents are merely decoys. To explain these deceptive practices, a firm may train employees who deal with these competitive issues. However, such training itself may leave a trail, exposing the firm's deceptions.

Alternatively, a firm could forgo discussing competitive issues on paper or in electronic form entirely. This, too, imposes communication costs, because now individuals must discuss competitive issues in-person or in telephone calls. Individuals must grow accustomed to not transcribing their thoughts on the competitive issues of the day or be prepared to destroy such documents almost instantly. Contemplation of competitive strategies would only be recorded in the minds of managers. In many businesses, such a state of affairs would be untenable.

Of course, subjective evidence that may show a firm's intent requires a credibility assessment, and courts must be vigilant of self-serving statements that are inconsistent with other facts. This challenge is not unique to antitrust law, as courts are constantly weighing the credibility of evidence in every case, from the criminal law case to the complex business tort.[772]

Fifth, we observe that there is a correlation between the type of effect a potential entrant has and the certainty of entry. When a firm's entry becomes more certain, evidence that the potential entrant is having a current, competitive effect on the market becomes less relevant. As we have observed, even if incumbent firms have no idea that another firm plans to begin competing with them, there is still an anticompetitive harm if entry is thwarted.[773] To the extent that a market is highly concentrated with substantial barriers to entry, certain entry by a firm is very likely to increase competition.

Alternatively, when a firm's entry is less certain, the need to show some kind of ongoing effect from that firm's presence on the sidelines of the market becomes more compelling. However, even in this situation, there should be some threshold showing that a firm can plausibly enter a market. To the extent a firm wishes to misinform the market about its possible entry for some strategic gain, it will become clear during the

772. *See, e.g.*, Florida v. J.L., 529 U.S. 266, 274-75 (2000) (Kennedy, J., concurring); Loinaz v. EG&G, Inc., 910 F.2d 1, 7 (1st Cir. 1990).

773. *See supra* note 286 and accompanying text.

course of a trial if a plaintiff or defendant argues that the firm is perceived as a potential entrant. Once it is shown that the firm is incapable of entry, the incumbents will use the newly gained information and disregard the firm as a potential entrant. Whatever constraint that firm had on the market will be forever eliminated. No antitrust remedy could ever bring it back.

Similarly, even if entry is absolutely certain, there must be some evidence that competition would be increased with entry. If no evidence exists, or if the evidence suggests the new entrant was going to produce a niche product in the market or operate on a very small scale, then the firm's entry will not be truly procompetitive and the application of the antitrust laws should not be disturbed by this fact.

Other special exceptions may alter this evidentiary burden. If a monopolist controls the ability of a firm to enter the market, a court should require less certainty of entry in the absence of proof of an ongoing effect on a market. And, if the market is nascent either from a removal of regulatory barriers or from rapid technological innovation, courts should be more wary of conduct that precludes potential competitors from entering.

This latter observation is likely to be viewed as controversial, as some commentators have argued that courts should simply step aside in nascent markets because the litigation process is too slow and may interfere with innovation.[774] We disagree. Such an argument would apply with equal force to the turn of the century when the railroad and oil businesses were nascent and vital to the economy. The considerable anticompetitive abuses that occurred during that era spurred the

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774. *See, e.g.*, POSNER, *supra* note 39, at 274-80; Richard A. Posner, *Antitrust in the New Economy*, 68 ANTITRUST L.J. 925 (2001); E. Thomas Sullivan, *The Jurisprudence of Antitrust Divestiture: The Path Less Traveled*, 86 MINN. L. REV. 565 (2002) (criticizing divestitures as an antitrust remedy in nascent markets). This criticism of antitrust enforcement is not new. Ron Chernow, for example, suggests that antitrust enforcement of the Standard Oil trust came too late. RON CHERNOW, TITAN: THE LIFE OF JOHN D. ROCKEFELLER, SR. 555-56 (1998). Market forces were already eroding the strength of the oil trust. *Id.*

Many commentators have been critical of the notion that antitrust law enforcement over the "new economy" should be more permissive. *See, e.g.*, Robert E. Litan, *Antitrust and the New Economy*, 62 U. PITT. L. REV. 429 (2001); Stephen F. Ross, *Network Economic Effects and the Limits of* GTE Sylvania*'s Efficiency Analysis*, 68 ANTITRUST L.J. 945 (2001); Lawrence A. Sullivan, *Is Competition Policy Possible in High Tech Markets?: An Inquiry into Antitrust, Intellectual Property, and Broadband Regulation As Applied to "The New Economy"*, 52 CASE W. RES. L. REV. 41 (2001); Jonathan M. Jacobson, *Do We Need a "New Economy" Exception for Antitrust?*, ANTITRUST, Fall 2001, at 89.

William Kovacic suggests some modest changes to enforcement to accommodate the quick pace of change in such industries. *See, e.g.*, William Kovacic, *Antitrust After Microsoft: Upgrading Public Competition Policy Institutions for the New Economy*, 32 UWLA L. REV. 51 (2001).

development of the antitrust laws.[775] Indeed, more aggressive enforcement may be well advised because it provides a more critical assessment of whether mergers or other potentially anticompetitive conduct truly enhances efficiency in an industry. Indeed, protecting competition in such industries could increase innovation and make the nascent industry stronger over time. Furthermore, even if the adjudication process is "too late" in one case, it sets out standards and discourages similar conduct in the future.

A final exception relates to whether the conduct is very likely to be injurious to competition. This exception appears in section 1 and 2 cases where a court may undertake a rule of reason analysis of weighing potential harms with efficiency benefits. If a court finds that the efficiency benefits are miniscule, and finds the harm to potential competitors would be high by precluding a potential competitor, the evidentiary burden should be lower for a plaintiff to prevail. Since there is little benefit from the conduct, potential competition should be protected even if somewhat more remote. This exception holds in a rule of reason case only when the market is highly concentrated and barriers to entry are substantial. If a court confronts a per se case, then concentration and barriers to entry are irrelevant.

Having set out these principles, we now turn to our test. We propose a simple two-step approach for a party moving to show entry with an opportunity for the nonmoving party to rebut the claim. The first step is to determine whether the firm intends to, and has the ability to, enter the market. Evidence that directly relates to the commitments and investments a firm has made for entry are the most direct and relevant. Sunk cost investments for entry, customer contracts, bids, entry plans, and other firm documents, such as e-mails, memos or consultant reports discussing entry, are all strong evidence of entry. In the strong cases—where there is a reasonable probability that a firm will enter a market—there is no need to move to the second step, because the moving party has met its burden of showing entry. At the other extreme, if there is no internal evidence that shows the firm was contemplating entry, or the evidence shows it rejected entry well before the conduct at issue in the case, then the moving party has failed to meet its burden and there is no need to move to the second step.

The more difficult case to show potential entry is one where the evidence is more equivocal and documents show an interest in entering

775. Many commentators have noted this point in their discussions of the new economy. *See supra* note 9. Other extensive histories of the Sherman Act confirm this view. *See, e.g.*, WILLIAM LETWIN, LAW AND ECONOMIC POLICY IN AMERICA: THE EVOLUTION OF THE SHERMAN ANTITRUST ACT (Random House 1965) (1954); HANS B. THORELLI, THE FEDERAL ANTITRUST POLICY: ORIGINATION OF AN AMERICAN TRADITION (1954).

the market, but it is more uncertain. A firm's exploration of entry may be in an early stage and the firm may be considering other alternatives, such as a merger or other competing business projects. The firm may have rejected entry as a strategy after considering the alternatives, finding others, such as an acquisition, more desirable. Entry may also be more remote because it may take several years to enter. Of course, future entry could be important in industries where entry requires a long time and barriers to entry are high. In these ambiguous cases, a moving party must go to the second step of the analysis.

The second step considers other factors that may influence the relevance of potential entry. The primary issue is whether the potential entrant firm has an ongoing influence on the market. To make this determination, the court may turn to external factors, such as general industry knowledge and the internal documents of competitors, to see if there is a perception that the firm is a potential entry threat. Econometric evidence that a potential competitor is constraining prices in the market is the strongest evidence.

If evidence of an ongoing effect is ambiguous, a court should consider three other factors related to the second step because econometric data does not bear out the effect, but documents or other information suggests incumbents perceive the firm as a potential entrant. If the market is marked by recent regulatory reforms, such as the changes occurring in the electricity and telecommunications markets, or is an otherwise nascent market, the second step should be satisfied with evidence that shows that the firm might have an effect on the market. For example, internal documents from players in the industry listing the firm as a potential entry threat when coupled with concern about greater competition would suffice.

Alternatively, if a court is examining a claim that either involves a per se or a rule of reason analysis under section 1 or 2, and the court concludes that there are miniscule efficiency enhancements to the restraint, a showing of only some evidence that a firm creates an ongoing effect on the market is sufficient to meet the second step. Finally, if the firm considered entry but was unable to enter because of the restrictive conduct of an incumbent firm, the second step is satisfied. When a moving party is unable to meet any of these alternatives, it has failed to meet a potential competition claim.

The nonmoving party has an opportunity to attack a potential competition claim in a number of ways. In cases where the moving party has shown that the firm is likely to enter, the nonmoving party could establish that entry by the firm will not discipline the market. We draw from the 1992 Guidelines in this respect, and note that a firm may be unable to discipline the market if it cannot feasibly enter at present market prices and output or if the anticipated scale of its entry would be too small to have a disciplining effect on the market.[776]

The remoteness of the entry date can also undermine a potential entry claim. However, remoteness is relative to the industry being examined. If a firm's entry plans are in ten years when it only takes one or two years to enter, then the remoteness argument defeats a potential entry claim. However, if it truly takes ten years to enter a market, the question becomes much closer, especially when the potential entrant is being acquired by an incumbent firm or faces anticompetitive behavior from an incumbent.

Another challenge relates to the potential entrant firm's fitness. For example, if the potential entrant has filed for bankruptcy, it would be unlikely to enter the market even if it had developed an entry strategy. Again, a moving party may challenge this type of attack if the bankruptcy was directly related to the incumbent firms' alleged restraints. And, other industry information, such as start-up failure rates, could be relevant to show a firm's inability to successfully enter a market. Of course, a nonmoving party may try to show that the firm would never enter the market. Finally, a nonmoving party could simply challenge the credibility of the evidence presented.

In addition to these tactics, a nonmoving party that is an antitrust defendant can show the existence of other potential entrants. To show such evidence, the nonmoving party must satisfy the two-step analysis we discussed above. The objective of such evidence is to dilute the level of concentration in a market and show that whatever the restraint or transaction, potential entrants will discipline the market. As the number of potential entrants increases, the vitality of an antitrust suit becomes weaker.[777] Determining at what point the number of potential competitors dilutes a high concentration of incumbent firms is essential for a court in this situation.

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776. *See supra* note 367 and accompanying text.

777. Posner argues another difficulty with ranking potential entrants in how they affect incumbents. When the most likely entrant is acquired, another one takes its place when there are multiple potential entrants. *See* POSNER, *supra* note 39, at 144. A similar critique could be lodged of merger enforcement generally when it is between incumbents because there may be some difficulty in discerning, beyond firm documents, which firm had an impact on the market. In many cases, this issue may not be very relevant because the number of potential competitors may be very small. For example, in a merger between an incumbent and one potential entrant, the fact that three others exist probably does not diminish concerns of anticompetitive harm from the transaction. Furthermore, firms may have created research that ranks firms, identifies brand familiarity or even assigns hypothetical market shares. *See, e.g.*, *NYNEX & Bell Atl.*, 12 F.C.C.R. at 20,056–57.

We caution against setting a magic number or attempting to assign market shares as some commentators have suggested.[778] Instead, a better approach is to examine the affected market on a case-by-case basis. When a court faces a nascent market or a market undergoing deregulation, it may be necessary to preserve competition by having five or six potential competitors in addition to an established incumbent. In more mature industries, fewer potential entrants could negate an antitrust claim. Finally, a court should evaluate the quality of the potential entrants themselves. When the potential entrant is more equivocal about entry, it presents a less compelling case for lowering market concentration than a firm certain to enter the market.

IV. TAKING THE NEW APPROACH FOR A TEST DRIVE

No proposed test is truly useful unless it works and derives sensible results. We present seven hypothetical fact patterns to apply our approach. Our analysis follows each fact pattern.

Hypothetical 1:

> Secure Company and Key Company both manufacture electronic readers and key systems used to access secure locations in a building. By and large, the systems are installed in office buildings and business is highly competitive. Five years ago, Secure adapted its technology to develop an optical scanning system that could be used to screen the identity of an individual. High security locations, such as military installations and certain government buildings, prefer this technology because it reduces the risk of unauthorized entry. The optical scanning systems cost more than the electronic key systems to install and to operate. At present, Secure is the only firm making the systems.
>
> Key's management has been worried about Secure's new optical scanning systems because it is bringing in significant profits, which could bankroll Secure's efforts to gain more market share in the electronic reader market, eroding Key's position.
>
> Key's management concluded that entry into the optical scanning market, while lucrative and feasible, was still not a priority and put off any research and development into entry for at least four years to pursue less profitable real estate

778. *See, e.g.*, 1984 GUIDELINES, *supra* note 150, § 4.133; BORK, *supra* note 39, at 260 (recommending a similar three firm safe harbor).

> projects that fit better with its long-term strategic plans. However, Key's management decides to leak information that it is developing an optical scanning system.
>
> Secure obviously gets wind of the misinformation and in response, reduces prices for optical scanning equipment and begins new research and development efforts to improve its system. Finally, one year later, Secure reaches an agreement to merge with Key. As soon as the deal is inked, prices rise for Secure's optical scanning systems.

One potential competition issue in this fact pattern relates to whether Secure's acquisition of Key will harm competition in the optical scanner market under section 7. Under the first step of our approach, we doubt that there is enough evidence showing that Key has the intent to enter, even though it may have the ability to enter. Key has decided that entry is not feasible for at least four years and has devoted its financial resources to the real estate business. In four years, Key planned to revisit the question, but there is nothing to suggest that it would change its position.

Even assuming Key decides to try to enter four years from now, it is unclear how long it might take to develop and commercially produce the product or whether the product would be successful. While there may be questions of credibility, Key has reached this conclusion one year prior to merger negotiations. It is possible that a change in management could reverse Key's business priorities, but such events seem speculative. If such an event occurred, entry might be delayed in the transition away from one set of business priorities—real estate—back to another—the optical scanning business. In that transition, Key may need to hire new research and development personnel to replace individuals it may have laid off. Although the optical scanning business appears to be a nascent market, it is unclear whether it will remain so when Key may decide to enter. In short, the delay in entry plans seems so remote that it amounts to a decision not to enter the market at all.[779]

A second antitrust theory of liability exists for Secure's proposed transaction under section 2. Secure is a monopolist in optical scanning technology and may be strategically eliminating would-be competitors to maintain that monopoly. The analysis on whether Key is a would-be

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779. A secondary issue is whether Secure could show that other potential entrants exist. It is unnecessary to analyze this issue because we believe that Key is not a potential entrant. The facts of our hypothetical do not provide enough information on this point.

competitor, however, remains the same as it is in our discussion of section 7.[780]

<u>Hypothetical 2:</u>

> Drawing from the same facts as Hypothetical 1, let us assume that Key's management had concluded that entry into the optical scanning market was not only feasible, but very attractive. As a result, Key began a research and development effort that lasted for one year. Internal memos indicated that it was about another three years away from commercially launching a product. The prototype, however, was still of somewhat inferior quality.
>
> Secure, unaware of Key's entry efforts, reaches an acquisition agreement with Key in order to strengthen its position in the competitive electronic key scanner business. Secure's prices have remained the same since it entered the market. Secure's management team had drawn up a list of logical entrants in the market and Key is one of six on the list. The document states that "entry might erode premiums." Other firms have likewise believed Key to be a possible entrant. As soon as the agreement is signed, Key halts all efforts to develop an optical scanning system and begins efforts to enter the real estate business that is less lucrative than the optical scanner business.

The potential competition issue in this fact pattern again relates to whether there is anticompetitive harm from Secure's acquisition of Key in the optical scanner market in violation of section 7 or section 2. The first step of our approach turns on whether Key has the ability and intent to enter the market. Key's management seemed interested in developing the optical scanner system until the merger negotiations and even developed a prototype product and found entry into the market attractive. These factors suggest that entry was a reasonable possibility, but not guaranteed. Other factors cast doubt on the certainty of entry, since Key's prototype is inferior to Secure's product and commercial production cannot begin for another three years. Thus, we must turn to the second step of our analysis.

While there is no evidence of an ongoing price effect from Key sitting on the fringe of the market, the market is a nascent one. Key

780. If this fact pattern were reshaped to show Secure's conduct to be akin to a per se violation of section 1, through a simple noncompete agreement, for example, the question of Key's role as a potential entrant becomes much less relevant, as we have explained.

will be only the second firm to enter the market if it does so. And, documents from firms in either the optical scanner system business or in the electronic scanner system business believe Key to be an entrant. Secure has also expressed some concern about increased competition from entry. As a result, the second step of our analysis is satisfied and Key is a potential competitor.

However, Secure can rebut this finding either with contrary evidence of potential entry, perhaps in the form of current testimony from Key's executives or putting its document in a different context, leaving a court to make some credibility judgments. It can also challenge whether Key's entry is of a sufficient scale to affect prices or whether the new product will have the same consumer audience. And, beyond these types of defenses, Secure can also attempt to show that other potential entrants exist. Because it is a nascent market, it would be desirable to bring forward a larger number of potential entrants in order to show that the anticompetitive effect of the acquisition is minimal.

Hypothetical 3:

> Two firms, eBook and eAccountant agree to enter into a joint venture. They both produce software for accountants. The joint venture agreement precludes them from competing against each other. Any joint venture in the industry would raise antitrust concerns based on the current concentration levels in the industry and the high barriers to entry unless there are potential competitors. Accounting software has been in popular use now for over twenty years, but market shares have shifted dramatically over the years between firms.
>
> Three firms have considered entry: MacroSoft, EuroAccount, and MiniSoft. In addition, there are at least six large software concerns in the United States that produce software for other industries and may have the capability of producing accounting software.
>
> MacroSoft, a large software manufacturer, has assigned programmers to begin working on a beta version of a program, but development is being stalled by problems with some of MacroSoft's other software. No definite release date is set, but it is widely known that the firm is committed to enter the market sometime next fall.
>
> EuroAccount is also interested in entering the U.S. market, as its two failed entry attempts demonstrate. Product reviewers panned EuroAccount's last two software offerings as inferior. EuroAccount is the largest European accounting

> software provider and could enter the U.S. market within six months.
>
> MiniSoft is secretly working with a large accounting firm to test a beta software product. The product is specialized to meet that accounting firm's needs, but could also be adapted for a larger audience. The accounting firm may consider purchasing the software. MiniSoft is a small software company that has no track record in the industry, and no one in the industry has ever heard of Minisoft.

This fact pattern raises potential entry as a defense in a case that could be litigated either under section 1 or section 7. There are four separate classes of potential entrants in this fact pattern that should be addressed under our two-step approach that a defendant could attempt to utilize. We address them below.

The first class of potential entrants is the six large software firms that apparently have the resources to enter the market. However, none of them has expressed an interest in entering the market, and, as the hypothetical states, entry barriers are high. Under our two-step approach, it is clear that these firms would flunk the first step since none of them evinces any intent or interest in entering the market. Thus, a defendant could not use them to counteract an antitrust claim.

MacroSoft represents the next class of entrants—the large firm with resources, that has expressed an interest in entering the market, and is developing a prototype. MacroSoft easily satisfies our first step since it has committed to a rough entry date of next fall that is publicly known and has a beta version that represents a sunk investment. Because MacroSoft is almost certain to enter the market, there is no need to reach the second step of our analysis. A plaintiff can attempt to rebut the entry claim, particularly if the evidence of MacroSoft's software problems will render the new product an inferior substitute, or if the software problems will significantly delay entry or prevent entry altogether. However, we do not have enough information in the fact pattern to discuss these matters.

EuroAccount represents the third class of potential entrants, the firm that has tried to enter the market before and has some experience in producing the software in Europe. Using our approach, EuroAccount clearly has the intent to enter the U.S. market again and can do so within only six months. However, it is less clear that it has the ability to enter the market. It tried to enter twice and failed both times. Reviewers concluded that EuroAccount makes bad accounting software. If the nature of those prior failures were related to other issues, such as prior inferior management, this determination would be closer. However, none of the facts suggest an alternative explanation.

MiniSoft represents the fourth class of potential entrants. Under our approach, MiniSoft appears to have the ability and intent to enter the market, at least for a niche product. However, it is not as strong a case because widespread entry into the market is not as definite as it was for MacroSoft. MiniSoft has not yet developed its product for a wider audience and it has not even gained customer acceptance of its niche product. Furthermore, as a start-up business, it is inexperienced in the software industry generally and may not survive. Thus, it is necessary to examine step two of the analysis to see whether MiniSoft is a potential entrant.

Since MiniSoft is developing its software secretly, and no one in the industry is really aware of the firm, it is unlikely that it is having any constraining effect on the market even though the facts are not completely explicit. Thus, one must examine whether MiniSoft fits into an exceptional circumstance. Accounting software was developed twenty years ago, suggesting that the market is not a nascent one. The fact pattern does not suggest that the market is undergoing deregulation or that any incumbent has attempted to retard its entry. Thus, MiniSoft is not a potential entrant under our approach.

Hypothetical 4:

> Edisron has an exclusive franchise to operate in City in the State to sell retail electric power. State is thinking of eliminating exclusive franchises in favor of competition. It passes legislation eliminating exclusive franchises in five years. Energex has publicly announced that it is considering entering the State and selling retail power in the former franchise territory of Edisron. Edisron's documents state that, if Energex enters State, no customer will switch to Energex and Energex will lose $250 million per year. Nonetheless, both Edisron and Energex have ad campaigns in the local newspapers and television stations, because the newspaper and television stations serve the customers in both Edisron and Energex's territories. Edisron and Energex propose to merge. The merger agreement forbids Edisron and Energex from competing for any service or product unless and until the merger is rejected by regulatory authorities or the DOJ, or other circumstances make the proposed merger infeasible.

This hypothetical illustrates the difficulty involved in determining whether two entities currently forbidden from competing could potentially compete in the future. Clearly, the merger takes place before any competition has commenced. The two companies are not presently competitors, but may very well be in the future.

The potential competition issues here relate to whether the merger will harm competition in the retail electricity market in violation of section 7, and whether the agreement not to compete prior to the merger is a violation of section 1.

The initial question under our approach is whether there is sufficient evidence to show that Energex has the intent and ability to enter. Energex has not—indeed cannot—incur sunk costs, solicit customers, make bids to service major retail customers or take any serious steps toward entry until the market opens.[781] However, Energex's advertising strategy, which is designed for its existing territory, effectively promotes its services and builds brand recognition to consumers in Edisron's territory.

Furthermore, Energex may have e-mails, consultant reports or other documents that have carefully scrutinized how Energex might fare in the retail electricity market in Edisron's service territory. If these documents indicate that Edisron would fail in its entry plans, then the moving party has failed to meet its burden. On the other hand, if these documents demonstrate a strong desire for the firm to enter the retail electricity market, the moving party has satisfied the first step. The evidence is, however, not strong enough to reflect a reasonable probability of entry, so we must go to the second step.

Under the second step of the test, evidence may exist that the potential entrant has an ongoing influence in the market. One such piece of evidence is the agreement itself, since it precludes the entrant from competing with the incumbent. Why would such an agreement exist if it served no purpose? Moreover, the overlapping ads may also indicate some influence in the market and reduced entry barriers for Energex. Edisron consumers who watch television and listen to the radio are probably aware of the Energex brand and its services. Edisron's customers may also know about Energex because their neighbors and relatives may live in the adjacent Energex service territory. Significantly, regulatory barriers exist that have been lifted. This should lower the burden of a moving party to satisfy the second step. The moving party satisfies its burden under the second portion of the test.

The nonmoving party may have an opportunity to attack a potential competition claim in this scenario by citing to any studies, mall-intercept surveys, and so on, demonstrating that Energex would not be a viable competitor to Edisron in Edisron's retail market or would not otherwise

781. One question not elicited from this fact pattern is what competition might look like. In retail electricity markets, the entrant may not need to incur substantial sunk costs, already having possessed substantial back-office operations, billing equipment, personnel, and so on.

have a disciplining effect on the market. Edisron's estimation that Energex would not capture market share is another significant point available to the nonmoving party. Alternatively, the nonmoving party could demonstrate that other competitors have greater positive brand name recognition or acquisition costs than Energex.[782]

The agreement not to compete is also implicated under section 1. This again raises issues relating to the second portion of the test. Here, there is a lower burden upon a plaintiff moving party to demonstrate that the two firms are potential competitors. The effect on the marketplace is unimportant under a per se analysis. If the purpose or effect of the agreement is to restrain competition, the nature of the agreement will dictate the nature of competition between the two firms for purposes of antitrust liability. Thus, a moving party must still satisfy the first prong of the test, but once it moves to the second prong, a showing of only some evidence of an ongoing effect in the market, however minimal, is adequate to satisfy the test.

On the other hand, if the agreement appears ancillary to a larger agreement (for example, a sale of assets) or has some legitimate purpose, then the plaintiff moving party must show, under a rule of reason analysis, evidence that the firm had an ongoing effect in the market or was otherwise deterred from entering via the incumbent's conduct. In this case, the moving party must follow the two-step approach described at the beginning of the fact pattern.

Hypothetical 5:

> Lightco is the sole producer of light bulbs. Lightco's light bulbs, however, tend to burn out quickly. Lightco is not troubled by this, and it fails to engage in any research and development. Newco has engineered a new light bulb that, if produced, would never burn out, would be indestructible, and would cost less than Lightco's bulbs. Moreover, the new bulbs would consume less electricity.
>
> Newco, however, has only engineered the bulb to attract Lightco's attention. In short, it produced the product with the hope that Lightco will buy out the product. Documents in Newco indicate that it has never considered entering the light bulb market. Subsequently, Lightco buys Newco.
>
> There are many firms currently developing light bulbs superior to Lightco's. Each company's e-mail indicates that

782. In other words, the costs of capturing customers are lower for other firms than for B. To its credit, the FCC considered these issues in the Bell Atlantic-NYNEX transaction. *NYNEX & Bell Atl.*, 12 F.C.C.R. at 20,052; *see also supra* notes 676–87 and accompanying text.

> they have no intent to sell in competition with Lightco, only that they seek to be bought out by Lightco. In fact, firms previously acquired by Lightco have had similar documents and similar products.
>
> Entry into the light bulb market is relatively cheap, given that light bulbs consist of only filaments, glass, and aluminum. Retailers of light bulbs have expressed an interest in having multiple firms providing such products (particularly if the product is packaged in a different color than Lightco's, making their stores less monotone).

As with the previous hypothetical, there are two potential competition issues present. First, there is the question of whether Lightco's acquisition of Newco violates section 7 by lessening competition in the light bulb market. The second question is whether Lightco is monopolizing the light bulb market. Again, there are innovation issues present.

We find here a double-edged sword in our test. First, we doubt there is enough evidence to show that any firm, let alone Newco, has the intent to enter, even though there appears to be sufficient evidence that entry is easy. Newco and others have decided that it is easier to make quick hit-and-run sales to Lightco rather than undertake even easy entry into the light bulb market. It is not clear from the fact pattern why this might be the case, but possible reasons may include fear (baseless or not) that Lightco will retaliate or perhaps a disinterest in selling light bulbs due to low profit margins. Lightco may even be willing to share to some degree the monopoly rents from its sales of light bulbs with its innovators. Regardless of the reason, for purposes of the merger case, it is fairly clear that Newco is not a potential entrant.

It would be no answer to suggest that the anticompetitive effect would take place in the innovation market. This is because such an acquisition is clearly vertical in nature. Lightco does not have a research and development department, and instead purchases the companies (and intellectual property) of others. Thus, the potential competition argument works equally poorly in reverse (Lightco as a potential competitor in the innovation market) as it does in the light bulb market.

However, there may also be a section 2 claim against Lightco based upon monopolization of the light bulb market and perhaps also monopolization of the innovation market.[783] Here, the facts do require

783. This hypothetical is similar to Alling v. Universal Mfg. Corp., 7 Cal. Rptr. 2d 718 (Ct. App. 1992). An unreported earlier federal case filed by LMP Corporation against Universal involving federal antitrust claims was dismissed on standing grounds. *See id.* at 729.

examination of potential competition issues only with respect to whether entry will reduce the effects of the anticompetitive conduct. The application of our test in this case would probably cease after the first step. There is no intent to enter the light bulb market by any innovator, although each may have the ability to enter. The fact that the innovators are in the business solely to provide products to Lightco is evidence of a lack of intent to enter. The fact that entry may be easy appears irrelevant (or misleading) if indeed no one in the past has entered and no current market participant intends to enter. In fact, in part the "reputation" of Lightco may be the very thing constraining entry, whether it is deserved or not. Thus, while there are no physical barriers to entry, psychological barriers certainly exist, and an examination as to the nature of those psychological barriers is necessary.

Hypothetical 6:

> The facts in this Hypothetical are the same as those in Hypothetical 5, except documents in Newco indicate that it has considered entering Lightco's bulb market, but fears being crushed by Lightco. Lightco buys Newco. Documents from Lightco indicate that Lightco considers Newco a "serious threat to the illumination market" and that Newco "will seriously erode Lightco's 100% market share."

This hypothetical is different from the one above in two regards. First, there is some serious debate as to whether Newco has the intent and ability to enter. This debate places some bind on the merging parties, however, as will be discussed below. Second, Lightco believes that Newco will enter the market and erode its market share, at least according to their documents.

The documents in the hands of both companies must be weighed for credibility. Were they created after the firms agreed to merge? Or, were they created well in advance of the merger before discussions took place? Who are the authors of the documents, and what role do they have in the company? These questions, and others, are questions commonly asked by antitrust investigators and weighed by the courts in their determinations of the weight that should be given to pieces of evidence.

Assuming the documents were not generated in anticipation of discovery, the test would be applied as follows. There is credible evidence that Newco has the intent and ability to enter the market but for Lightco's perceived or actual conduct. However, as we cautioned in the previous section, a monopolist should not be rewarded for a damning reputation that deters entry. If Newco had the intent and ability to enter but for Lightco's conduct or reputation, then the moving party has satisfied prong one of the test.

Even if the analysis led to the conclusion that, under prong one, entry was not sufficiently proven, the moving party would likely be victorious on prong two. This is because Lightco's documents may indicate that Newco had a disciplining effect on the market. Clearly, Lightco anticipated erosion of market share if Newco entered, meaning that the intent of the merger was to lessen competition (or the potential for competition) in the light bulb market. Of course, the nonmoving party can use other evidence, such as pricing, to demonstrate that Lightco did not change its pricing or other behavior and therefore, Newco did not affect competition; but, the nonmoving party in this case must have some means of justifying the merger and explaining the Lightco documents. Merging parties typically have little trouble doing this, but with varying degrees of credibility.

Hypothetical 7:

> Defendant TexAir is the dominant airline in Salt Lake City. TexAir has a substantial hub in Salt Lake City, and has 100% market share on many nonstop routes to and from Salt Lake City. In addition, in other routes (from Salt Lake City to the hubs of other carriers) it is one of two competitors.
>
> Redjet, a low-cost carrier, decides to enter the Salt Lake City to Ontario route. Prior to this announcement, Redjet had been in the process of starting operations by hiring pilots, securing aircraft, and doing other tasks required by regulation and prudence in order to begin operations. At the moment it announces entry, Texair reduces its advanced purchase fares and announces that it will add five flights to that route. Redjet announces that it will not serve that route. Texair retracts its flight addition announcement and raises its advanced purchase fares.
>
> Prior to this saga, another low-cost carrier, Myth Airlines, had similarly attempted to enter the Salt Lake City to Ontario route, and left under similar circumstances after serving the route for only a week. It now serves Ontario to Las Vegas.
>
> Texair asserts that Redjet declined to service the route for reasons other than Texair's conduct and therefore there was no injury to any relevant market. Moreover, Texair asserts that Myth is a potential entrant that restrains any anticompetitive effects. More generally, Texair asserts that all carriers are potential entrants into that route.

> Since the airlines were deregulated, no airline but Texair has ever serviced that route for more than a month. Documents from Myth indicate that to enter the Salt Lake City to Ontario route would be "sheer suicide" and would "awaken the sleepy giant that has allowed us to live in the less lucrative Ontario to Las Vegas market." Documents from other carriers demonstrate that they occasionally consider entering the route, but have never done so.

This hypothetical is, of course, a substantial alteration of the facts presented in the AA case.[784] There are three potential competitor issues present here. First, there is the issue of Redjet's near entry into the route in question. Second, there is the issue of Myth's relevance to the relevant market. Third, there is the issue as to whether other carriers are potential competitors.

Turning to the first step of our analysis, we reach two different conclusions with respect to our three classes of potential entrants. With respect to Redjet, it is very clear that entry was imminent. In order for a start-up airline, that has not yet begun operations, to enter a route, it would have had to secure financing, receive regulatory approval from the Department of Transportation and the Federal Aviation Administration, obtain leases for jets (or buy new ones), and engage in numerous expenditures, most of which represent sunk costs. Thus, there would be no need to undertake the second step of the analysis, as the evidence points to a reasonable probability that Redjet would have entered the market.

With respect to Myth, it is unlikely TexAir could show that there is a reasonable probability that Myth would enter the route. While Myth has previously attempted to enter this route, it exited the route quickly. Moreover, its documents show that it is not inclined to engage in reentry, equating it to suicide. The evidence fails to meet the reasonable probability requirement of step one, meaning that the defendant has failed to meet its burden and there is no need to proceed to the next step.

With respect to other carriers, the analysis may be trickier. Internal documents indicate that the route has caught the attention of other carriers. Moreover, incumbent carriers are able to move planes around—especially the larger carriers—and thus may more readily enter the market. On the other hand, they have never entered the route. Thus, under step one, the result is ambiguous and an analysis under step two is necessary.

Under step two, it appears that the incumbent carriers do not have much influence on the market. The fact pattern indicates that Texair

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784. *See supra* Part II.E.2.

raised prices after the exit of a low-cost carrier. This indicates that the incumbents do not have any meaningful effect on prices on the route. If the incumbents were disciplining price, there would be greater hesitation on the part of Texair to raise prices after the exit of Redjet. Internal documents from Texair may also shed light as to whether pricing or capacity decisions on this route are made with incumbent carriers in mind.

V. CONCLUDING OBSERVATIONS

It is time for the potential competition doctrine to be resurrected. Since the 1970s, the doctrine has found itself living in the shadows of antitrust—used increasingly in cases without its name being uttered too loudly. At the same time, the potential competition concept has emerged as an important tool for antitrust defendants under the rubric of entry analysis.

It is striking that the result arrived at under the case law depends largely upon who is wielding the doctrine, and whether it is wielded as a weapon or shield. Regardless of whether it is used as a plaintiff's theory to block a merger or demonstrate anticompetitive conduct, or a defensive theory to show that there are no anticompetitive effects from a transaction or certain conduct, the same core issues are involved. The increasing use of multiple antitrust claims (that is, alleging violations of sections 1 and 2 of the Sherman Act and section 7 of the Clayton Act simultaneously) has caused much muddling of the analysis. With different standards being imposed in different cases to determine identical issues, plaintiffs may run the risk of proving too much to meet a section 1 claim and yet destroy their other claims. Unfortunately, antitrust case law has created artificial barriers between these concepts, creating inconsistent, conflicting, and sometimes contradictory approaches to the same basic problem.

We propose to resurrect the potential competition doctrine in a form different from its previous incarnation. In its new form, the potential competition doctrine would be necessarily simplified in order to create a uniform approach for its various applications.[785] Scholars critiquing this area of law have similarly failed to see the forest for the trees in this very important area of the law.[786] Yet, the economic

785. We observe that we are not lone voices in making this plea. While we do not wish to focus on his views, we note that Posner has recognized the need for a more uniform approach to antitrust law analysis in other areas. *See* POSNER, *supra* note 39, at 259-65.

786. As we have observed, no commentator has comprehensively discussed the concept of potential competition considering, for example, entry analysis as a defense. We note that the major treatises discuss these issues separately without much consideration of them as an integrated concept. *See, e.g.*, AREEDA & HOVENKAMP,

literature has recognized the important competitive effects of potential competition.[787]

In our Article, we set out five guiding principles in the application of potential competition concepts that we believe will help establish a better approach to the problem:

(1) There should be no "extra" burden of high entry barriers or a highly concentrated market in any potential competition claim beyond what is required in any other antitrust case.
(2) Regardless of the antitrust statute or violation invoked, the rules for proving or defeating a claim that a firm is a potential entrant should be uniform.
(3) Regardless of whether a party is an antitrust plaintiff or defendant, the same burden for showing potential entry should apply, with the exception of section 1 per se violations.
(4) A trier of fact should consider both "objective" and "subjective" forms of evidence to determine whether a firm is indeed a potential entrant.
(5) There is a correlation between the likelihood of entry and the need to show a current market effect from a potential entrant. As entry becomes less certain, a moving party must show more evidence of a current ongoing effect in the market. We recognize there are certain exceptions to this general rule.

We have also proposed a two-step approach to showing whether a firm should be considered a potential entrant. The first step examines whether a firm had the intent and ability to enter the market. If the evidence shows that there was a reasonable probability that the firm would have entered, based on this information, a moving party has satisfied its burden to show potential entry. When there is no such evidence, the moving party has failed to meet its burden. If there is some evidence, but it falls short of showing a reasonable probability of entry, then the moving party must turn to the second step.

In the second step, the moving party must show some ongoing impact on the market that is related to the potential entrant. The evidence must show that it was reasonably likely that the firm had an ongoing influence on the market. If there is no such evidence, the

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supra note 4, ¶¶ 1100–64 (discussing the potential competition doctrine in the context of conglomerate mergers); SULLIVAN & GRIMES, *supra* note 26, § 11.3b (discussing the potential competition doctrine in the context of conglomerate mergers).

787. *See supra* Part I.

moving party has failed to meet its burden. However, if there is some evidence, but it falls short of a reasonable likelihood, the moving party has also failed to meet its burden unless the case falls into one of three special exceptions: (1) the market is marked by recent deregulation; (2) the violation alleged is a per se violation of section 1 or the conduct falls under the rule of reason under either section 1 or 2 and the efficiencies from the conduct are miniscule; or (3) the alleged antitrust violator is responsible for the firm's inability to enter.

A nonmoving party has a variety of options to challenge a potential competition claim, including the potential entrant's inability to discipline the market, the remoteness of entry, the entrant's fitness to actually enter or other evidence that may undermine the credibility of the moving party's evidence. Antitrust defendants have an additional tool: to allege that additional potential entrants exist. Generally, as more potential entrants exist, the weaker a plaintiff's theory will be. Beyond this observation, we hesitate to assign a specific number of potential competitors as necessary to eviscerate an antitrust claim. A case-by-case approach is probably desirable.

It is our hope that we have established an impetus to resurrect the potential competition doctrine from the dead. Many industries are in the throes of deregulation, where, at least at the outset, all competitors are potential competitors. Even in deregulated markets, potential competitors play a significant role, and enforcement agencies and regulators require some means of determining whether a potential competitor disciplines competition. And, even in markets where deregulation is absent, the potential competition doctrine ought to play a significant role in determining whether a less restrictive means of entry into a market other than a merger is available for a competitor waiting on the edge of a market.

Finally, it is our hope that the Supreme Court takes note that one of its better antitrust decisions, *El Paso*,[788] has been subjected to several decades of erosion. It is time that *El Paso*, like the phoenix, rises from the ashes of the potential competition doctrine jurisprudence of the last forty years.

788. 376 U.S. 651.