Analysis of Foreclosure in the EC Guidelines on Vertical Restraints

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Chapter 12

ANALYSIS OF FORECLOSURE IN THE EC GUIDELINES ON VERTICAL RESTRAINTS

Steven C. Salop

I. INTRODUCTION

The antitrust treatment of vertical restraints is quite controversial. In the United States, for example, warring vertical restraints guidelines were issued by the Department of Justice and National Association of Attorneys General, a group of antitrust enforcers from the individual states. However, a consensus was never achieved and these guidelines never entered the mainstream. Compare them to the U.S. Horizontal Merger Guidelines, which have become a template for evaluation of horizontal restraints.

The new EC Guidelines on Vertical Restraints Guidelines ("GVRs") represent a significant effort to create and implement a consistent analytic framework for evaluating vertical restraints. The scope of the project is quite significant. The category of vertical restraints represents a broad set of practices that raise an array of issues - efficiencies, collusion, foreclosure, intrabrand vs. interbrand competition and so on.

In this short article, I examine the central foreclosure issues in the GVRs. I focus mainly on the general enforcement policy, though I do discuss the block exemption regulation at the end. I examine the GVRs through the lens of economic analysis and the U.S. antitrust laws. I do not touch on resale price maintenance, market allocation or franchising. Even aside from space limitations in this article, I have chosen to focus on foreclosure because it is the

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1. Professor of Economics and Law, Georgetown University Law Center, Washington.
3. U.S. Department of Justice & Federal Trade Commission, Horizontal Merger Guidelines (1992, as amended in 1997, reprinted in 4 Trade Reg. Rep. (CCH) ¶13,104. In my own antitrust economics and law course, I spend about 20% of the classes on the horizontal merger guidelines, using them as a vehicle to teach antitrust economics. I do not even assign the vertical restraints guidelines, which for that matter are not included in the casebook that I use.
more difficult and controversial area. For example, the recent Competitor Collaboration Guidelines issued by the U.S. antitrust agencies did not cover exclusion at all. In contrast, the GVRs examine limited distribution, exclusive distribution, single branding and exclusive supply in detail.

The antitrust evaluation of vertical restraints is comprised of the analysis of procompetitive efficiency benefits and anticompetitive harms. The efficiency benefits involve coordination of incentives and elimination of various types of free riding. As for potential harms from exclusives, two theories of foreclosure may be distinguished. Input foreclosure arises when a vertical agreement requires an input supplier to sell exclusively or on more favorable terms to one buyer, and thus discriminate in some way against other potential buyers. Customer foreclosure arises when a contract requires the buyer to purchase most or all of its needs of a particular product from a single supplier. Depending on the vertical restraint, one or both of these types of foreclosure can arise.

This article is organized as follows. Section II sets out the basic analytic framework. Section III examines the procompetitive efficiency benefits. Section IV examines input foreclosure and Section V examines customer foreclosure. The limited role of competition for exclusives in constraining foreclosure also is discussed in this section. Section VI briefly discusses the role of exemptions based on market shares.

II. BASIC ANALYTIC FRAMEWORK

The GVRs focus on agreements between manufacturers and their wholesale and retail distributors. However, the same approach could easily be applied to other exclusivity agreements between input suppliers and the output producers that purchase their inputs. It also could be applied to exclusive contracts between sellers and final consumers.

In evaluating exclusivity and foreclosure concerns, it is important to distinguish which party is restrained by the exclusive. Consider an "exclusive" agreement between a manufacturer and a distributor. An "exclusivity" term in their contract could require that the manufacturer sell only to the distributor. Alternatively, it could require that the distributor purchase only from the manufacturer. Of course, the contract could specify both types of exclusivity. The GVRs are concerned with both types of exclusives. "Single branding" involves a distributor buying most or all of its requirements from a single manufacturer. ¶106. "Limited distribution" involves a manufacturer selling only to one distributor (or one distributor in a particular area or for resale to a particular group of customers). ¶109

These different types of exclusives raise somewhat different analytic issues. In my own work, I distinguish between two types of foreclosure

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concerns, which I denote as "input" and "customer" foreclosure.\(^5\) Input foreclosure involves a situation in which an input supplier refuses to sell or discriminates against certain buyers. Those buyers are foreclosed from the input. In the manufacturer/distributor context, this corresponds to what the GVRs call "limited distribution." Customer foreclosure involves a situation in which a customer refuses to buy or limits its purchases from certain sellers. Those sellers are foreclosed from selling to the buyer. In the manufacturer/distributor context, this corresponds directly to what the GVRs call "single branding."\(^6\)

In a market economy, competitors are expected to compete. As a result, cooperation among competitors is considered exceptional. Cooperation among competitors can lead to reduced costs and improved products. However, the risk of price fixing and customer allocation makes such "horizontal" agreements inherently suspicious to antitrust enforcers and regulators. Cooperation between sellers and buyers is the opposite. Goods and services cannot be produced unless buyers and sellers cooperate in some way, at least by transferring inputs from sellers to buyers, who then convert those inputs into outputs that can be sold to consumers. As a result, "vertical" agreements between suppliers and buyers are not inherently suspicious.

Antitrust analysis of vertical restraints involves the economic evaluation and balancing of potential procompetitive benefits against potential anticompetitive harms, in order to gauge the net competitive impact of the restraints on consumer welfare and aggregate economic welfare. The GVRs use the terminology "negative effects" for anticompetitive harms and "positive effects" for procompetitive efficiency benefits.

In antitrust, this type of full competitive analysis sometimes is truncated with permissive exemptions and safe harbors. In other situations, it is truncated by summarily condemning the conduct with per se rules of illegality. However, even in these situations, an ex ante balancing of benefits and harms of the class of restraint provides the analytic foundation for these rebuttable (or irrebuttable) legal presumptions.\(^7\) In this regard, the GVRs provide exemptions under the Block Exemption Regulation ("BER") and Article 81(3). The GVRs do not apply any rules of per se illegality in the analysis of foreclosure theories. I discuss the BER market share rules briefly at the end of the article.

Antitrust and competition analysis involves two competing economic welfare standards. A "consumer welfare" standard evaluates restraints in


\(^6\) As discussed below, the analysis of input foreclosure also applies to a situation where a distributor agrees only to serve a single manufacturer. This is because distribution services can be viewed as an input that the manufacturer purchases from distributors. Thus, "single branding" can be evaluated as input foreclosure too.

\(^7\) For a recent review of this "decision theoretic" approach to summary disposition, see F. Beckner and S. Salop, Decision Theory and Antitrust Rules, 67 Antitrust L. J. 41 (1999) and the references cited therein.
terms of their effects on consumers. Under this standard, cost savings and other efficiency benefits created by the restraints are cognizable only if they are shared with consumers by being passed along to consumers in the form of lower prices or superior products. If restraints injure competitors, that competitor injury does not count for its own sake. In some cases, that competitor injury may lead to consumer harm, which then does count. However, consumer harm is not inevitable and may not be presumed merely from the fact that competitors are injured. After all, producing a better product also harms competitors even as it benefits consumers.

A competing antitrust standard is the "aggregate welfare" standard. (It sometimes is referred to as an "efficiency" standard.) This standard grades restraints on the basis of their aggregate impact on all participants—consumers, the parties adopting the restraint and their competitors. The aggregate welfare standard is indifferent to transfers of wealth among these parties. The efficiency benefits need not be passed through to consumers in order to count.

The issue of injury to competitors creates significant confusion. For example, Robert Bork stressed that efficiencies should count in antitrust; he was a driving force in the U.S. courts' recognizing the importance of efficiency benefits. Bork also argued that courts should view injury to competitors as insufficient to condemn restraints. He argued that competitors complain about conduct that increases efficiency and benefits consumers and competition. Despite this recognition, however, Bork failed to embrace the consumer welfare standard. Although he states that the goal of antitrust is the maximization of consumer welfare, he adopted the aggregate welfare standard instead. This standard does not require the pass-through of efficiency benefits to consumers. It also would treat competitor injury as part of the balance, irrespective of its effect on consumers. Bork never comments on this confusing inconsistency.

The GVRs do not present a perfectly clear picture of their underlying welfare standard. In some places, they seem to have in mind a consumer welfare standard in which efficiency benefits must be shared with consumers in order to count. For example, in discussing the relevant factors under Article 81(3), the GVRs state that permissible vertical restraints must have efficiency benefits. In addition, the GVRs state that "the vertical agreement must allow consumers a fair share of these benefits." Indeed, ¶134 goes on to say that the vertical restraints must be "indispensable" to attain the benefits. This approach then is developed in more detail in ¶136.

The next three sections evaluate in turn the procompetitive and anticompetitive effects of exclusives involved in vertical restraints.

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9. However, the GVRs are not always clear about whether they require proof of likely harm to consumers to condemn a restraint or whether harm to competitors by itself is sufficient, as discussed in more detail later on.
III. PROCOMPETITIVE BENEFITS OF EXCLUSIVE CONTRACTS

Exclusive contracts can be procompetitive. They can facilitate a type of vertical integration "by contract" and other sources of consumer benefits. Integration can create efficiency benefits by improving product design and product quality. Other efficiency benefits may arise from eliminating free riding or coordinating incentives in other ways. Consumers also benefit from lower prices or superior products that coordination may bring. Where such efficiency benefits occur, they can reduce the potential harm from exclusivity or might even lead to a net consumer welfare benefit instead of a net consumer harm. Thus, the analysis of efficiency benefits is included in the economic analysis of impact on consumers.

Exclusive contracts can improve coordination between the parties to the exclusives. In particular, exclusives can eliminate free riding and induce greater focus on activities that serve the joint interests of the parties to the agreement. In this way, competition can be increased and consumers can gain. Thus, if efficiency claims are real and not simply a pretext for adopting anticompetitive exclusives, they imply the need to balance harms against benefits according to the appropriate welfare standard.

The GVRs examine the procompetitive benefits of exclusive contracts in §1.2. A number of specific efficiency justifications are set out in §116. The general issue of acting in the mutual interest of the parties is not discussed explicitly. This paragraph does examine the role of exclusive distribution in resolving free rider problems. Consistent with the GVRs' focus on the relationship among manufacturers and distributors, the discussion is focused on promotional free riding, certification and similar manufacturer/dealer issues. The paragraph also raises the potential that exclusives would be necessary to open up new markets, achieve economies of scale, avoid holdups and so on.

The GVRs express a concern about the potential scope of these efficiency justifications and imply some skepticism towards broad efficiency claims. This is made even clearer in §§134-36 in setting out the conditions for applying the exemption under Article 81(3). In these paragraphs, the GVRs set a very high standard on vertical restraints alleged to create efficiency benefits. First, the restraints must be "substantiated." They cannot involve just "general statements on cost savings." Second, the efficiency benefits must dominate any anticompetitive concerns so that they lead to an increase in consumer welfare. Third, the restraints must be "indispensable to the attainment of these benefits." Fourth, the GVRs suggest the possibility that the restraints must be the "least anticompetitive" alternative.

These conditions are similar in some ways to U.S. antitrust law and differ in other ways. The first two conditions are discussed in the evaluation of

10. In §101 the GVRs recognize that incentives can change when the upstream and downstream firms share profits. In that paragraph, they focus on potential anticompetitive harms, not procompetitive benefits. However, the same sharing of profits also incentivizes the firms to take greater procompetitive actions that increase joint profits.
"cognizability" of efficiency benefits in the U.S. merger guidelines. The third condition, the GVRs' "indispensability" standard, seems to set a higher standard than the "reasonably necessary" standard commonly used in U.S. antitrust law and recent guidelines. As for the fourth condition, a "least anti-competitive" alternative standard sometimes is viewed as implicit in the "reasonably necessary" test in U.S. law and sometimes is viewed as a more stringent standard. The more stringent test remains controversial.

IV. INPUT FORECLOSURE

One type of competitive concern can be characterized as input foreclosure. This involves the potential anticompetitive effects raised when a firm becomes the exclusive customer of its input suppliers or when those suppliers provide their inputs on more favorable terms to the firm. Such agreements may disadvantage the firm's rivals in the output market by cutting off their supply or raising their cost of critical inputs. Not only may such an input market disadvantage injure rivals, it also may harm the customers of the output market competitors by giving the excluding firm the power to raise or maintain its prices above the competitive level. That is, the exclusive agreements may give the firm what might be termed exclusionary market power.

These inputs may be unbranded inputs in the production of a commodity, such as electricity for smelting aluminum. The inputs can be components used to create a finished product or system, such as tires for an automobile or an operating system for a computer. A retail distributor views the brands that it resells as inputs. At the same time, as illustrated in Example 3 below, a manufacturer may view retail distribution as an input into the sale of its product. (This issue is also discussed in the customer foreclosure section.)

A. Two-Step Analysis of Consumer Harm

The potential anticompetitive harm from this type of exclusivity strategy can be determined by a two-step analysis of the structure and conduct in input and output markets. The first "raising rivals' costs" step examines whether rivals' input costs are raised or their efficiency is degraded. The

11. This point is made explicit in the Competitor Collaboration Guidelines. As they state in section 3.2, "an agreement may be 'reasonably necessary' without being essential. However, if the participants could achieve an equivalent or comparable efficiency-enhancing integration through practical, significantly less restrictive means, then the Agencies conclude that the agreement is not reasonably necessary." (emphasis added)

12. The analysis of exclusion in this section and the next relies on a number of my own articles and the references to others' articles cited there. For example, see T. Krattenmaker and S. Salop, Anticompetitive Exclusion: Raising Rivals Costs To Achieve Power Over Price, 96 Yale L.J. 209 (1986); M. Riordan and S. Salop, supra note 6; S. Salop and R. C. Romaine, Preserving Monopoly: Economic Analysis, Legal Standards and Microsoft, 7 George Mason L.R. 617 (1999).
second "power over price" step examines whether prices paid by consumers in the output market are increased, relative to the appropriate competitive benchmark.

1. *Raising Rivals' Costs*

The first step evaluates the impact on input prices and rivals' costs. This step involves potential injury to competitors. The inquiry here focuses on the issue whether competitors' costs of the foreclosed input will likely increase as a result of the exclusives. In particular, it evaluates the number and quality of alternative suppliers along with the prices they likely will charge. As a general matter, if rivals can substitute to equally cost-effective alternative inputs and the effectiveness of input market competition is not reduced, then there would be no competitor harm. Of course, if competitors are not disadvantaged, then there can be no significant consumer harm either.

The existence of input suppliers who are not tied up by the exclusive arrangements means that rivals have options and are not totally foreclosed. However, other input suppliers may not be sufficient to prevent rivals' costs from being raised. First, the ability of remaining input suppliers to expand may be constrained by capacity limits. Second, their costs and prices may be higher than the suppliers who are parties to the exclusives. Third, if there are only a small number of unrestrained suppliers, they may have the incentive to raise their prices in response to the exclusives. This is because they no longer face competition from the input suppliers who now have been tied up by the exclusives and can no longer sell to certain potential customers. In this sense, the exclusives may facilitate tacit or express collusion among the unrestrained suppliers still available to the rivals. This last condition sometimes is overlooked in vertical restraint analysis. Doing so creates a significant potential for error.

2. *Power Over Price*

The second step evaluates the impact on output prices flowing from any cost increase borne by the rivals. This step involves potential injury to consumers. The inquiry here focuses on the issue of whether output market prices will likely increase or whether rivals in the relevant output market, both the excluded firms and other firms that produce close substitutes, instead will maintain the ability and incentive to compete effectively. Because there may be close substitutes for the product of the firm that achieves the exclusives and its competitors, injury to these competitors does not necessarily imply injury to consumers. Instead, competition among non-excluded firms may remain intense and there may be competition with other firms that have their own exclusives. This last point means that multiple exclusives actually may cause less of an anticompetitive effect, a type of "reverse" cumulative effect, as discussed in Example 2 below. Competition with substitute products also may prevent prices from rising.
If rivals' costs are raised, the firm that obtains the exclusive may be able to gain market power to raise prices in the downstream (output) market. This power over price may involve either unilateral action or tacit coordination with downstream competitors. The parties to the coordinated conduct may include those competitors disadvantaged by the higher input costs or other exclusionary conduct. In a sense, these partially excluded rivals could be said to be involuntarily induced to cooperate, as a result of their higher costs. In this way the integrated firm achieves market power, that is, the power to price above the competitive level in the output market. As discussed below, this power may involve raising price above the pre-exclusion level or maintaining a high price in the face of competition that otherwise would have forced price down.

Where both these steps are proved, the exclusionary conduct harms consumers and reduces economic efficiency, absent offsetting procompetitive efficiency benefits. Consumers are harmed by the higher downstream prices. Efficiency can be reduced in two ways by this conduct. First, a consumer deadweight loss results if and when consumers reduce their purchase levels. Second, the higher costs borne by rivals may lead those firms to utilize an inefficient input mix or may lead relatively more efficient firms to reduce their market shares.

This raises a distinction between this achievement and exercise of exclusionary market power and classical market power. The classical market power of a monopolist permits it profitably to raise and maintain price above the competitive level by restricting its own output. Exclusionary market power is the power profitably to raise or maintain price above the competitive level by conduct that raises the costs or otherwise disadvantages competitors in the output market. Exclusionary market power does not require the excluding firm also to have classical market power. If rivals' costs are increased by being foreclosed from an input, they will restrict their output and raise price, permitting the excluding firm to increase its output price too. In addition, the exercise of exclusionary market power sometimes involves preventing entry or raising the cost of entry of competitors that otherwise would drive output prices down.

The analysis of the exclusives and the relevant market must be sensitive to the type of anticompetitive allegation. In particular, where the allegation is that the exclusives will prevent prices from falling, then competition from other firms or other products that would constrain prices from rising above the current, pre-exclusive price level would not prevent the alleged anticompetitive effect. The fact that prices cannot rise does not mean that they cannot be prevented from falling. Analysis that is not sensitive to this issue is prone to error. This issue is illustrated in Example 4.

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B. Illustrative Examples

This section sets out some examples to illustrate the analysis of input foreclosure.

1. Example 1: two-step approach

There are 4 major producers of portrait cameras used by professional portrait photographers. A new "flash" technology has been developed that uses halogen bulbs and computerized timing. There are three developers in this area, each of which has its own patented technology. The leading camera producer, which has a 40% market share, has made exclusive agreements with two of these three halogen flash technology companies.

**Analysis:** These exclusives can reduce the quality of rivals' camera offerings or raise their costs. There is one developer left. However, that developer's technology may be inappropriate for some of the camera competitors or more expensive. In addition, realizing that it no longer faces any competition in selling to the three camera companies, this one remaining developer may exploit its quasi-monopoly position by raising its price. If the camera competitors' costs are raised or their quality reduced, the leading camera company may gain the ability to raise or maintain its camera price. As a result, camera purchasers may be harmed.

A change in facts can alter the conclusions. If there were six competing flash technologies instead of three, then the likelihood that exclusives with two of them would disadvantage rivals would be reduced. Four choices would remain, despite the exclusives. In the downstream market, if portrait cameras are not distinct but face intense competition from other 35mm cameras, then the leading firm may be unable to raise its price, even if it successfully can disadvantage other portrait camera rivals.

2. Example 2: Multiple buyers with exclusives

Videoworld is the largest video movie rental chain in several member states, followed closely by California Video and Videomax. These three retail chains account for 70% of all video rentals, with the rest accounted for by small stores and mail order sales. Videoworld recently made an agreement with the distribution arm of one of the five major movie distributors for an exclusive that permits Videoworld to obtain a two-month exclusive on its choice of 20% of the new movies offered by this distributor each year. California Video and Videomax followed this by striking their own similar exclusivity deals with two of the other distributors.

**Analysis:** This series of agreements cuts off the smaller video rental stores' access to 20% of the new videos offered by three of the five distributors. This can place them at a disadvantage by cutting off their early access to the newest hit videos. At the same time, they can continue to compete on remaining non-exclusive videos and are unencumbered by the exclusives after two months, as well as all the new videos offered by the other distributors.
Whether or not these retail competitors are significantly disadvantaged in the market involves the degree of substitutability among these classes of videos and competition among the distributors. This analysis includes, of course, the same type of substitution analysis that would be used for determining whether the sale of new, hit videos constitutes a separate relevant market, though the focus is somewhat altered.

A second issue involves the fact that multiple video rental chains have exclusives. The GVRs (at ¶133) raise the issue of the "cumulative" effect from multiple exclusives. The "cumulative" exclusivity here increases the likelihood of an adverse impact on rivals that do not have such exclusivity agreements, as well as potential entrants. However, it does not inevitably increase the likelihood of an adverse anticompetitive effect on consumers. Competition among the three chains with the exclusives will continue. In fact, it may intensify if the exclusives have significant procompetitive benefits, say by eliminating free riding.\footnote{In particular, the rationale for the exclusives needs to be investigated. It is possible that the purpose and effect of the exclusives are to increase promotion of the videos and reduce free riding. For example, as part of the exclusivity agreements, perhaps the chains promised to stock more copies of the videos in order to avoid an out-of-stock situation. In addition, perhaps the chains promised to significantly increase their promotion of the exclusive videos. Even without the exclusives, their incentives to promote would reasonably be expected to increase from the exclusives because other chains would not share in the additional rentals generated by the advertisements. Coupled with the fact that the three exclusives tie up only 20\% of the new videos for only three of the five distributors, the impact on competition may be procompetitive on balance.} If the exclusives create efficiency benefits that reduce costs, then the competition can lead to even lower prices as then more efficient firms compete more effectively. Thus, merely assuming that such multiple exclusives magnify the competitive concerns may lead to error.

3. Example 3: Distribution services as inputs

The sale of "consumable" office products by office "superstores" has been a growing phenomenon. These stores have lower costs that tend to translate into lower retail prices. There are three office superstore chains in Europe: L'Office Max, Euroclips and Bernhards. These three chains compete with each other and also with the numerous stationary stores and other retail outlets that distribute consumable office products. The leading producer of transparent tape recently has made agreements with each of the three superstores to carry its tape exclusively, in exchange for a substantial lump sum annual payment to the stores.

Analysis: Although products flow from the manufacturer to the retailer and then to the customer, the supply of retail distribution services can be viewed analytically as inputs into the sale of products by manufacturers. Examined in this way, these exclusives may raise the distribution costs of the competing tape manufacturers by foreclosing them from the lowest cost distribution channel. Thus, even if these tape companies remain viable, their
high distribution costs may give the leading tape company the power to raise or maintain a non-competitive price.

In the statement of the example, it was stated that the exclusives were secured by lump sum payments to the distributors. Economic theory predicts that lump sum payments are not passed on to consumers in the form of lower prices. However, if the exclusives instead were secured by providing the distributors with discounted wholesale prices or payments tied directly to sales levels, the results are different. In this case, the retailers would have lower variable costs and, thus, a greater incentive to pass through at least a portion of the discount to consumers in the form of a lower retail price. Similarly, suppose that the agreements require the retailers to reduce their retail prices. Such "variable" payments would reduce the potential harm from exclusives and make it more likely that they would benefit consumers. 16

4. Example 4: Avoiding price competition

Trialsoft is the leading provider of litigation support database software, with over 50% of the market. Law firm offices purchase litigation support software. It requires extensive training and customer support over time as the product improves. The companies rely on independent consultants to provide the training, particularly the consulting arms of the large accounting firms. A new database entrant, NeuralSearch, has created an innovative database program that uses neural network techniques that dramatically improve the efficiency of searches and permit linkages to be taken to higher dimensionality. Trialsoft has only just begun to work on upgrading its product using neural network techniques and is still 1-2 years away from having a product as good as the current release of NeuralSearch's product. NeuralSearch is in the process of soliciting consulting firms to sell and support its software. To counter the entry of NeuralSearch, Trialsoft has begun to require its distributors to sell only its database program. The consulting firms would prefer to sell both programs because most clients do not need the complexity of the NeuralSearch product and Trialsoft's other competitors mostly appeal to specialized customer niches.

**Analysis:** The possible competitive concern here is that the Trialsoft exclusives will delay or deter the entry of NeuralSearch, if NeuralSearch cannot find sufficient alternative dealers. Absent substitute dealers, consumers may be denied access to the superior NeuralSearch product as well as to the price and innovation competition that it may induce in Trialsoft. It is true that Trialsoft faces competition from firms other than NeuralSearch and this competition does constrain Trialsoft's prices to some extent. However, because it has a superior product, NeuralSearch may be able to create a degree of competition that those products cannot. As a result, NeuralSearch's entry

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16. In carrying out the analysis of this issue, it is important to ensure that the discounts were not based on or accompanied by wholesale price increases and that net wholesale prices actually were reduced.
may force Trialsoft to reduce its prices and innovate faster. The timing of Trialsoft's new exclusivity policy also is suspicious. Competition for exclusives is unlikely to deter Trialsoft market power in this situation. NeuralSearch is not well positioned to obtain an exclusive because its product appeals only to a limited group of clients. Even if NeuralSearch and the others would band together, it is still not clear that the consulting firms would view them as a good alternative to Trialsoft in an all-or-nothing competition for exclusives. In addition, it would be difficult for NeuralSearch and the other niche competitors to coordinate a response to Trialsoft. That coalition likely would face free rider problems and other transactions costs.

C. Application to the GVRs

The GVRs' analysis of "limited distribution" (at ¶109-10) and "exclusive distribution" at ¶161-77) is generally consistent with the basic theory of input foreclosure, where the inputs are the brands resold by the distributor. Thus, when a manufacturer limits its number of resellers or has an exclusive distribution system in which it sells to only a single reseller in an area, it forecloses the other dealers from access to the "input" it produces. As stated in ¶103, this can raise barriers to entry. It can also facilitate collusion at the buyers' level in the output market, as discussed in ¶167.

As explained in ¶24, the GVRs cover all types of vertical agreements. However, the GVRs focus mainly on manufacturer/distributor relations, not the broader type of exclusives or favoritism that might arise with respect to other inputs used in the production and sale of goods and services. In fact, in ¶96(i) the GVRs suggest that vertical restraints for intermediate goods generally are less worrisome. Similarly, in ¶119 (5) the GVRs conclude that vertical restraints for "non-branded" goods and services generally raise fewer competition concerns because differentiation reduces the degree of substitution. Inputs such as electricity used in aluminum production would seem to fit within this category of non-branded goods.

However, this approach may be too permissive. Even if inputs are not differentiated, significant competitive concerns nonetheless can be raised when the input producers' costs differ or where there is limited capacity. Concerns also can arise when the input market is sufficiently concentrated that elimination of the restrained supplier from the exclusive gives the remaining suppliers the ability and incentive to coordinate to raise their prices.

Paragraph 119(5) also suggests that there are fewer concerns about intermediate goods (i.e., inputs) because buyers tend to be more sophisticated. Sophisticated buyers who account for a large share of a seller's sales clearly can help to deter price increases. However, that point does not seem to be the focus here. Moreover, these conditions do not inevitably occur for intermediate goods.

Another issue involves the distinction between injury to competitors and injury to competition. The theory of input foreclosure set out above requires a showing of likely injury to the consumers who purchase in the output.
market. This injury could arise either from unilateral market power by the distributor who has the exclusive or from coordination between that distributor and others. Such proof of likely consumer injury generally is required under U.S. antitrust law when manufacturers unilaterally adopt vertical restraints.\(^\text{17}\)

It is not entirely certain under what circumstances the GVRs require proof of injury to competition versus the circumstances in which evidence of injury to the excluded competitors is sufficient. On the one hand, ¶96(i) clearly seems concerned with downstream effects and seems to suggest the type of two-step analysis set out above. As stated in this paragraph:

\[
\text{a vertical agreement may not only have effects on the market between supplier and buyer but may also have effects on downstream markets. For an individual assessment of a vertical agreement, the relevant markets at each level of trade affected by the restraints contained in the agreement will be examined.}
\]

In a similar vein, ¶103 discusses barriers to entry and ¶119(1) discusses market power (presumably downstream) and loss of interbrand competition. Similarly, ¶119 (5) talks about injury to "competition." In addition, the second harm mentioned in ¶110 involves the potential for the restraints to facilitate tacit or express collusion in the output or input market. Collusion in the output market (where the distributors operate) would typically lead to consumer injury, so this would be consistent with proof of power over price.\(^\text{18}\)

On the other hand, ¶110 does not make it perfectly clear whether likely harm to final consumers is required. As stated in ¶110, one of the three possible negative effects on competition is that "certain buyers within that market can no longer buy from that particular supplier, and this may lead in particular in the case of exclusive supply, to foreclosure of the purchase market." The issue becomes whether "foreclosure of the purchase market" means injury to consumers or whether it simply means injury to the competitors who are denied access to the product. That is, in terms of the


\(^{18}\) Express collusion in the input market would be illegal under U.S. law, irrespective of its impact on downstream markets. If it involves only tacit coordination that is facilitated by the fact that the exclusive eliminates a competitor, then impact in the downstream market probably also would be required.
terminology used above, is it enough to prove that the exclusives likely lead to "raising rivals' costs," or must the government also prove that the downstream firm likely gains "power over price?"

Another possible difference between the statement of input foreclosure here and the GVRs involves the treatment of multiple exclusives and cumulative foreclosure. For example, the concern about collusion in ¶ 110 is focused on the situation in which "most or all of the competing suppliers" limit the number of retailers. However, multiple exclusives are not necessary to cause a potential coordination problem under the input foreclosure theory. For example, if exclusives raise the cost of one or more downstream rivals of the firm that adopts the exclusive, those higher costs could facilitate pricing coordination among the downstream firms. Indeed, Jonathan Baker has described the impact of such cost-raising strategies as pushing the foreclosed rivals into an "involuntary cartel" in the downstream market. Exclusives can facilitate express or tacit collusion among the input suppliers because the exclusive eliminates the competition from the restrained supplier.

At the same time, as discussed in Example 2, the fact that multiple suppliers have exclusives does not necessarily cause a reinforcing, cumulative effect that facilitates collusion. It is also possible that continued competition among the distributors that have exclusives can prevent prices from rising. In fact, if the exclusives create efficiency benefits that reduce costs, then competition may be intensified and even lead to lower prices under some conditions.

As discussed above, exclusives can lead to prices above the competitive level. These price effects sometimes involve a firm that already has some market power being able to "enhance" its market power by using exclusives to raise price further above the competitive level. As written in ¶ 119(1), the GVRs appear to focus only on this case of "enhancing" market power. However, this is not the only potential competitive harm. Vertical restraints also may permit a firm that initially lacks market power in the world without exclusives to "achieve" market power as a result of the exclusivity. Or, they can allow a firm with market power to "maintain" its market power by raising the costs of new entrants or fringe firms that otherwise would cause price decreases in the absence of the exclusives.

The GVRs' focus on firms that already have classical market power also raises another potential limitation on the constraints they place on the firms' conduct. The GVRs state in ¶ 120 (1) that the first step in the competitive evaluation is the determination of the relevant market. To avoid errors, relevant markets should not be defined in a vacuum but rather in the context of the anticompetitive allegations. For example, in the U.S. "duPont" monopolization case, the Supreme Court committed what is now known as

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the Cellophane Trap. Because duPont was charging the monopoly price for cellophane wrapping, it could not profitably raise its price any more. Indeed, this is the very definition of the monopoly price. Rather than recognizing that duPont's monopoly was the cause of the unprofitability of additional price increases, the Supreme Court erroneously concluded that duPont lacked market power in a broader flexible wrapping market. By defining the relevant market first, and in the absence of any detailed evaluation of the potential harms of vertical restraints, the GVRs sometimes may commit the classic Cellophane Trap or a related error. This obviously also could be a major problem in certain cases in which the block exemption regulation is applied, as discussed in more detail in Section VI.

V. CUSTOMER FORECLOSURE

Customer foreclosure refers to using exclusive contracts and other strategies that exclude rivals from access to a sufficient customer base. If the use of exclusives can reduce the sales of a competitor sufficiently, that competitor may be driven below minimum viable scale (i.e., break-even sales level) and forced to exit from the market. Even if it does not exit, it may suffer higher marginal costs that limit its ability to compete effectively. It may also face reduced incentives to engage in non-price competition. As a result, the exclusives may harm competition by giving the excluding firm the power to raise its price or maintain a price above the competitive level. Alternatively, the exclusives may harm competition by leading to higher prices in a related output market.

Of course, where the competitive instrument of customer foreclosure is solely offering low prices to consumers, consumer injury clearly is less likely and antitrust law is rightfully skeptical. Whatever long-term consumer harms may occur from any resulting foreclosure must be balanced against the immediate consumer benefits from the lower prices. For this reason, antitrust standards for proving predatory pricing have tightened considerably over the past two decades.

This analysis also raises the question of how the firm is able to induce its customers (either distributors or final consumers) to accept the exclusives. One obvious way is for the excluding firm to "purchase" the exclusive, either


in the form of a cash payment or a quid pro quo for some reciprocal favor. Such "carrots" can induce customers to go along. The cost of these exclusionary rights is unlikely to prevent the arrangement because the exclusionary rights allow the firm to achieve or maintain market power over many other customers. Of course, the smaller victims of the exclusives can try to induce the distributors to continue to stock their products. However, competition for exclusives does not take place on a level playing field. In addition, the prospects of these supracompetitive profits should be sufficient to allow the larger firm to compensate the exclusive customers for reducing their choice. As discussed below, competition is a "public good" and each individual customer and supplier has a natural inclination to act as a free rider.

A. Illustrative Examples

1. Example 5: Basic analytics

An exciting new innovation in photofinishing involves a self-service film-developing machine. The consumer places the film cartridge in the machine and the prints or diskettes with digitized images are produced fifteen minutes later. The machines also can produce prints from diskettes. The two firms producing these machines, Cadko and Eurofilm, have competing technologies and their machines have somewhat different features, advantages and disadvantages. Cadko was the first entrant and followed a strategy of exclusive contracting with the largest grocery and drug store chains in exchange for large lump sum payments. When Eurofilm came on the scene, it found that Cadko already had exclusives with a significant number of the large chains. Cadko also has told potential customers that Eurofilm will fail and they will be stuck with its expensive machine. This has led other chains to reject Eurofilm's product because of a fear that Cadko's headstart would cause Eurofilm to fail.

Analysis: This use of exclusives prevents the chains from giving final consumers a choice by placing both machines in their stores. They also might cause Eurofilm's entry to fail. The lump sum payments for the exclusives likely are not passed through to consumers and Cadko does not require the chains to charge lower prices, so there are no direct consumer price benefits from the exclusives. The exclusives also could eliminate longer run price and innovation competition by preventing Eurofilm from reaching minimum viable scale and instead causing it to exit from the market. Thus, the exclusives may cause consumer harm. In contrast, if Eurofilm can sign up a sufficient number of exclusive retailers itself, then it would not be driven out of business. Potential efficiency rationales also would be relevant to competitive evaluations.
2. Example 6: Relationship to input foreclosure

Recalling Example 2, office product office "superstores" have lower costs. There are three office superstore chains in Europe: L'Office Max, Euroclips and Bernhards. These three chains compete with each other and also with the numerous stationery stores and other retail outlets that distribute consumable office products. The leading producer of transparent tape recently has made agreements with each of the three superstores to carry its tape exclusively, in exchange for a substantial lump sum annual payment.

**Analysis:** This problem was previously analyzed as input foreclosure. It was seen there that the exclusives could raise the distribution costs of the tape competitors. This problem also can be seen as customer foreclosure. If the tape competitors are unable to arrange efficient alternative distribution channels, their sales may be driven below minimum viable scale, forcing them to exit. Alternatively, their lower customer base may reduce their incentives to advertise, further entrenching the dominant firm. Their incentives to innovate also may be compromised, allowing the dominant producer to maintain its market power in the future.

3. Example 7: Impact in related output market

Referring back to Example 5, Cadko is the largest film producer in the world. Cadko's self-service photofinishing machines work best with its own film. Competing film comes out somewhat grainy. This "problem" was not corrected by a recent software upgrade that did improve the quality for Cadko film. This "problem" does not arise with the Eurofilm machines. As the self-service machines have become established, Cadko's market share in the sale of film has risen significantly. In addition, there are rumors in the financial press that Cadko's largest film competitor has canceled some research and development projects because of cash flow shortfalls.

**Analysis:** This example illustrates how an exclusive in one market (e.g., photofinishing) can have effects in related markets (e.g., film). Even if there is no competitive harm in the photofinishing market, the exclusives could lead to anticompetitive effects in the film market. The impact on related markets is necessary for a full competitive valuation.

4. Example 8: Exclusives with final customers

A daily newspaper in a small town faced no competition for readers or advertisers until a new free weekly newspaper recently entered the market. Advertisers view the weekly as a partial substitute for the daily newspaper and have begun to shift some of their advertising to the weekly. In response to this entry, the daily newspaper announced a new exclusivity policy by which advertisers must devote either all or none of their newspaper advertising to it. The newspaper refused advertising from several advertisers who did not follow its policy, which has led all of its big advertisers to drop their advertising in the weekly. As a result, the weekly is suffering large
losses and has announced its intention to cease publication unless the situation improves significantly within the next three months.

**Analysis:** Advertisers are customers of newspapers, not distributors. However, exclusives with ultimate customers can have anticompetitive effects. In this example, the all-or-nothing exclusive contract can deter the entry of the weekly newspaper. The weekly cannot totally replace the daily for most advertisers, but only supplement it. By forcing advertisers to choose in this way, the exclusives will reduce the customer base for the weekly, possibly driving it below minimum viable scale. Even if there are enough advertisers who could switch their entire advertising budget to the weekly, they may be afraid to try, because if the weekly fails despite their business, the daily newspaper may subsequently retaliate against these advertisers by charging them higher prices. Alternatively, the daily may exploit the fear that the entrant will fail, by inducing advertisers, to sign long-term exclusive agreements in exchange for small payments.

**B. Application to the GVRs**

The GVRs apply the analysis of customer foreclosure to "single branding" restraints in ¶106 and then in more detail in Section 2.1 (¶¶138-60). "Single branding" refers to a buyer concentrating his orders for a product with one supplier. This specialization can restrict the market available to other suppliers. In particular, where the buyers are distributors, the other manufacturers may lack adequate distribution as a result. Or, as stated in ¶107, this may lead to "foreclosure of the market." As the GVRs point out, this theory also applies to tying, where the foreclosure involves the "tied" product market. (See also ¶¶215-24). It also is applied to exclusive supply (at ¶¶202-14).

The GVRs discuss a number of relevant factors for evaluating such restraints. I will highlight some of them here. One key factor is the market position of the buyer. The larger the buyer taking the exclusive, the smaller the customer base remaining available to competing suppliers. This factor is stressed in ¶125 and ¶141. The GVRs explain why the market share of the buyer is relevant to evaluating customer foreclosure. Entry barriers at the buyer's level also are relevant in evaluating the degree of real foreclosure, as explained in ¶144.

The market position of the supplier also is discussed. I found this discussion in the GVRs somewhat confusing. Even if there are numerous other efficient suppliers available, there can still be competitive harm if one of the suppliers ties up a large number of buyers. In effect, the exclusives can raise barriers to entry to other suppliers. As a result, the supplier with the exclusives will gain market power and increase its market share. Thus, the "initial" market position may be less relevant than the impact on the barriers facing competing suppliers.

This seems to be an issue of the guidelines being unclear rather than logically flawed. ¶127 recognizes the effect of exclusives on barriers to entry in general. When the analysis is applied to the single branding issue in ¶144,
the GVRs point out that barriers to entry on the buyers' level is relevant to evaluating whether the exclusives can cause barriers to entry and competitive problems at the suppliers' level. As ¶144 states, if it is "relatively easy for competing suppliers to create new buyers," then foreclosure is "unlikely to be a real problem."

The GVRs also discuss the issue of cumulative effects with respect to single branding. As discussed in ¶149, concerns are expanded when multiple suppliers tie up a limited number of available buyers. (See also ¶206). Multiple exclusives do increase the barriers to entry facing competing suppliers. However, as mentioned earlier, the ultimate consumers may be protected by the continued competition among the suppliers and buyers that have the exclusives. The GVRs apparently are more skeptical of the strength of this competition.

In some cases, a combination of input and customer foreclosure can permit a vertically integrated firm to entrench market power by raising barriers to entry. This occurs when the exclusives, in effect, force new entrants to enter both the input and output markets simultaneously. This is sometimes referred to as the "two-level entry" problem. By raising the sunk capital costs of entry, requiring the entrant to have expertise in both markets and creating coordination costs, two-tier entry is more likely to be deterred than would be entry into a single market. The GVRs mention this issue in ¶127. Then, in ¶171 they point out that the combination of exclusive distribution (input foreclosure) with single branding (customer foreclosure) increases the likelihood of harm. (See also ¶207, with respect to exclusive supply).

C. Competition for Exclusives

This analysis of exclusives in both input and customer foreclosure raises the question of why the entrants cannot simply compete in the "market" for exclusives. To the extent that the exclusives create procompetitive efficiency benefits, competition might well be maximized when each of the firms has some exclusives. For example, this is the case with television programs. A particular program is broadcast exclusively on one network, and each network has its own exclusive programs. A similar type of structure was described in the Videoworld and the (first) Cadko example.

The GVRs are sensitive to the role of competition for exclusives in preventing anticompetitive harm. As stated in ¶108 with respect to single branding (customer foreclosure), the "reduction in inter-brand competition may be mitigated by strong initial competition to obtain the single branding contracts." Confidence in the constraining power of competition for exclusives has led a number of U.S. courts to take a very permissive approach to exclusives with a short contractual duration.24

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In my view, however, the constraints created by competition for exclusives should not be overestimated when there is a dominant firm or the market is highly concentrated. This process differs from competition in the sale of goods and services in a number of significant ways that can limit its benefits to consumers. To begin with, when a firm pays a supplier, distributor or customer to deal exclusively with it, it is not simply paying to obtain an additional supply source, or channel of distribution, or customer for itself. It also is paying for the right to exclude rivals from that supply source or channel of distribution or customer. In fact, that exclusion may be the sole or primary function of the exclusivity. This is not to say that exclusives are always anticompetitive. Exclusives can eliminate free riding, improve coordination or create other efficiency benefits. Efficiency benefits, however, are not inherent in exclusives. Exclusives instead might reduce competition by destroying rivals' efficient access to key inputs, make experimentation more difficult and raise switching costs. Stated most simply, the firm may be purchasing market power as well as a channel of distribution or source of supply or additional customer.

There are a number of other reasons to be skeptical of the consumer protection provided by competition for exclusives. First, in some situations there may not be real competition for the exclusives. An incumbent firm may obtain long term exclusives before there is another competitor on the horizon. By the time the entrant is poised to enter, the input suppliers may be tied up in long-term exclusive contracts. This situation was suggested in the Cadko example. For the reasons discussed later on, one cannot count on the suppliers to make decisions that adequately protect the interests of consumers in these circumstances.

Second, even where competition for exclusives does occur, it may not take place on a level playing field. The exclusive tends to be worth more to a dominant incumbent than undoing the exclusive is worth to an equally efficient entrant. This is because the entrant can earn only the (more competitive) duopoly return, whereas a dominant incumbent may earn the monopoly return if entry is deterred or significantly constrained. For example, suppose that the incumbent could earn $200 if it gets the exclusive and so retains its monopoly. If the entrant gets distribution and breaks the monopoly, suppose that the entrant and incumbent each would earn $70, for a total of $140. Because competition transfers wealth from producers to consumers, the total profits fall from competition (e.g., from $200 to $140). In this case, the entrant would be willing to bid up to $70 to obtain distribution, an amount equal to its profits from entry. In contrast, the incumbent would be willing to bid up to $130 for an exclusive that prevents the entry, an amount equal to the reduction in its profits from competition. The incumbent thus would win the bidding. This result obtains for as long as the aggregate market profits fall
from competition. This example also shows why competition for exclusives can not be assumed to reach the efficient outcome.

This is not a "deep pocket" argument. The incumbent's bidding advantage comes from the fact that it has already sunk the costs of entry together with the fact that monopoly profits exceed the profits in the more duopoly or competitive post entry market profits. Entry barriers are raised because the entrant's need to outbid the incumbent artificially raises its fixed costs of entry. The bidding disadvantage faced by the entrant is "artificial" in the sense that the exclusivity does not have real and direct efficiency benefits in the example, but instead has the sole effect of raising barriers to entry.

Third, exclusives increase switching costs and eliminate the ability of suppliers or consumers to experiment by devoting only a portion of their business to the entrant. This in turn raises their risk of switching. For the entrant, this decreases the likelihood that entry will succeed. This increased difficulty of coordination and the resulting barriers to entry and expansion are reinforced if the exclusive contracts are long-term and have "staggered" expiration dates. These factors extend the period before the entrant can achieve viability. They also reinforce the consumers' or suppliers' expectations that the entry will not succeed, which may in turn make them less willing to take the risk of foregoing the exclusive in order to remain available to the entrant. As a result, they may require larger inducements to switch to the entrants, thus raising entry costs still further.

This analysis of experimentation and switching costs suggests another reason why the entrant may face a bidding disadvantage. The retailers may not find the entrant's product adequate as its only offering, whereas the incumbent's product may be sufficient. In this situation, the entrant does not desire (or could it practically obtain) an exclusive. Instead, it wants only to maintain non-exclusivity. As discussed in the Trialsoft example, the distributor might be able to substitute a number of independent brands for the incumbent. But, in a bidding situation, these independent firms would face coordination problems in bidding against the dominant incumbent.

Fourth, even if exclusives are terminable at will or embedded in short-term contracts, they still may erect a difficult coordination problem for an entrant. This increases the risk that the entrant will be unable to get enough distributors or enough customers to rapidly achieve minimum viable scale and maintain adequate investment incentives. Bidding still does not take place on a level playing field. The exclusives also can lead retailers to expect the entry to fail, raising the fees the entrant must offer. This is because it is


26. By "staggered" expiration dates, I mean that the contracts do not all expire at the same time. This increases the coordination problem and entry costs facing the new entrant. If all the contracts expired at the same time, the entrant might be able to coordinate its entry with the start-up dates of its own contracts. Of course, getting enough users to switch at the same time is itself a difficult coordination problem. Thus, staggering is not necessary for there to be a competitive problem.
difficult to convince enough suppliers or consumers to switch at the same time.

This is not to say that competition for exclusives has no constraining effects at all. It can. This is because the need to purchase exclusives also is costly to the incumbent firm. This cost of buying exclusives can act as somewhat of a deterrent. The constraint, however, is limited and does not eliminate competitive concerns. Nor can the existence of this competition or exclusives restricted to short durations legitimately provide the basis for an exemption from antitrust scrutiny. The more important question is whether the exclusives create real procompetitive efficiency benefits and whether those benefits will be passed on to consumers in a competitive output market. This is most likely when exclusives are divided up among the competing firms in the output market.

This last point raises the question of why retailers or consumers ever would cooperate by agreeing to an exclusive that might allow a firm to achieve market power. This result, however, can occur because an individual distributor or consumer ignores the effect of its decision on others. As a result, the dominant firm can compensate the retailer or consumer for its own harm and still earn money from the incremental power gained with respect to others. In addition, if a retailer or consumer believes that the entrant likely will fail because others are granting exclusives, then it would not require significant compensation to grant exclusivity as well. Both these reasons flow from the same point: competition is a public good.

VI. THE MARKET SHARE THRESHOLD UNDER THE BER

The GVRs provide a block exemption when the market share of the supplier does not exceed 30%, as discussed in §89. For exclusive supply agreements, the block exemption will apply when the buyer's market share does not exceed 30%, as discussed in §21 and §92. Such exemptions (or "safety zones") are common in governmental guidelines. 27 I will not comment directly on the determination of the market share levels chosen. Various guidelines in the United States also have set safe harbors at the 20-30% level.

I want to focus instead on the determination of the relevant market from which these market shares are calculated. It should be clear from the analysis set out in this short article that the determination of the relevant market is not a trivial exercise. Vertical restraints involve the analysis of a number of markets - the market for the input, the market for the output and the market for related outputs. Distributors might be viewed as providing an input to manufacturers or as the customers of manufacturers. Shares in more than one market are relevant to the outcome. Thus, if market shares are to be used as

27. In the United States there are safety zones in the Horizontal Merger Guidelines, in the FTC's Health Care Statements 7 & 8, in the DOJ's Intellectual Property Guidelines and in the Competitor Collaboration Guidelines.
proxies, they would be more useful if they were gauged in both the upstream and downstream markets relevant to a full competitive analysis.

In addition, the proper relevant market depends on the type of anticompetitive allegation being considered. The market relevant to a claim that a vertical restraint will cause prices to rise above the current (pre-restraint) level may be different from the one relevant to a claim that a vertical restraint will prevent prices from falling below the current level. This was explained in detail in the discussion of the Cellophane Trap. In particular, a determination that a firm has a low market share in a broad market might be relevant to restraints that could permit prices to rise in the future. But, it would not be relevant to restraints that would raise entry barriers and prevent post-entry prices from falling.

As a result, the use of antitrust exemptions and safety zones is prone to error. This is less of a concern if the exemption is applied at the conclusion of the evaluation, once all the relevant theoretical and factual analysis has been carried out. At that point, however, a safety zone is no longer needed. The conclusion can be based on all the information, not just the market share level. When exemptions are used as a short cut to truncate the evaluation at a preliminary stage, however, then there is a serious concern that the market shares will be based on the wrong relevant market. By limiting the evaluation solely to market share and ignoring entry barriers and other highly probative evidence, the accuracy of the prediction is further reduced.28

Exemptions and safety zones are favored because they are said to increase business' legal certainty, as the GVR's note in ¶22. This can be true, but only if the market definition methodology is not sensitive to the concerns raised in this article. If the enforcement agencies, however, properly tailor the market definition methodology to the particulars of the allegations, then the business certainty is lost unless the advisors are able to accurately predict the agencies' concerns. If business certainty is achieved only by limiting the evaluation to a single market determination that may or may not be the more probative market definition, then the business certainty will come at the expense of accuracy.

For these reasons, I am somewhat skeptical of the value of these exemptions and safe harbors. In the situations in which it is obvious that no competitive concerns are raised, a formal exemption is not needed because the outcome is obvious. In the more difficult situations, the exemption can and will lead to significant policy errors. Nor will much certainty be achieved. Businesses need to hire lawyers and economists to determine the proper relevant market. The market definition methodology is complex and fact based, so that it often is difficult to predict with a high degree of certainty what the enforcement agency will determine as the relevant market. This

28. The Commission appears aware of these issues but is concerned about making a "radical change" and providing a "lower level" of legal certainty. Communication from the Commission on the application of the Community competition rules to vertical restraints (Follow up to the Green Paper on Vertical Restraints) (Undated), http://europa.eu.int/comm/competition/antitrust/others/.
point is illustrated by the complexity of the market definition analysis in the Videoworld example.

To the extent, however, that there is a commitment to using market share thresholds to define a safe harbor, accuracy can be improved in the following way. First, the markets should be defined in the context of the particular anticompetitive concerns raised about the vertical restraints. In particular, the relevant markets definitions might vary according to whether the relevant competitive concern involves exclusion or collusion, and whether it involves achievement of market power or maintenance of pre-existing market power. Second, market shares should be gauged in both the upstream and downstream markets. For example, the safe harbor might only apply if the market shares of the group of restrained and restraining firms both are less than 30%. Of course, accuracy would be further increased if the analysis would include evaluation of entry barriers.