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What's in a Name? The Defining Riddle of Barriers to Entry in American Antitrust Law

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"The antitrust laws are shot through with inconsistency, incongruity and incomprehensibility."[2] A portion of the resulting confusion revolves around the concept of barriers to entry.[3] What constitutes a barrier to entry? Theoretically, anything that makes entry into a market impossible or even more difficult is a "barrier."[4] In the quest for a jurisprudence that protects consumers and allows for maximum competition, scholars, judges, and enforcement agencies have arrived a seemingly infinite number of conclusions. One thing that is clear is how one defines "barrier to entry" is a reliable indicator of whether or not she will determine if a barrier exists and what legal action is appropriate. This paper will first examine the competing definitions of "barrier to entry." Second, this paper will survey the case law demonstrating the confusing results of these competing definitions. Finally, this author will offer possible solutions to the problem.

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[1] Grace College, United States.
[2] Eliot G. Disner, Antitrust Law for Business Lawyers 9 (2nd ed., ALI-ABA 2003).
[3] A logical question in response would be : "entry into what?" The answer is the market. A market is loosely defined as any institution or mechanism which brings together buyers and sellers of a particular good or service. Campbell McConnell & Stanley Brue, Economics, 34 (14th ed. McGraw Hill 1999). There are of course, an infinite number of "markets" in the world. Much depends on how one chooses to define the market in which a barrier may or may not exist.
[4] "Barrier" is defined as "something that separates, demarcates or serves as a barricade" by The Merriam-Webster Dictionary 57 (Frederick Mish ed., Merriam-Webster 2004).

Antitrust law essentially boils down to a few prohibitions.[5] The Sherman Antitrust Act declares every contract, combination or conspiracy in restraint of trade to be unlawful.[6] It is also unlawful to monopolize, attempt to monopolize, or combine or conspire to monopolize.[7]

Corporate mergers, acquisitions and joint ventures that may substantially lessen competition or tend to create a monopoly in a market are unlawful.[8] The linguistic simplicity of the antitrust statutes disguises the complexity of antitrust law. In fact, some have suggested that the Sherman Act is little more than a legislative command to the judiciary to develop a common law of antitrust.[9] However, it is from these statutory commands that the concept of barriers to entry into a market arises. In an attempt to comply with the Sherman and Clayton Acts, courts have begun to analyze entry barriers and their effects on competition as a means for rooting out the statutorily prohibited behavior, namely monopolies. There is no statute making entry barriers themselves unlawful. The concept of barriers to entry is however, crucial to antitrust law.

Barriers to entry are important to the analysis of both market definition and market power.[10] When determining market definition, barriers to entry are relevant for assessing whether firms can come into the market and constrain price increases by incumbent firms.[11] When measuring market power, barriers to entry may allow for maintaining prices that exceed some competitive norm, thus leaving a firm with monopoly power.[12] If one sees barriers to entry everywhere, his inclination might be toward extensive intervention into the workings of the market to curb the power of incumbent, potentially monopolistic, firms. If one does not see these obstacles as actual barriers to entry, he is likely to be less inclined toward intervention. Thus, the definition of barriers to entry is paramount in many antitrust analyses.

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[5] This is, of course, a gross simplification. Many of the words used in a few relatively short statute sections are pregnant with meaning and fertile grounds for debate. For these purposes, a general overview will have to suffice.
[6] Sherman Antitrust Act, 15 U.S.C. § 1
[7] Sherman Antitrust Act, 15 U.S.C. § 2
[8] Clayton Act, 15 U.S.C § 15
[9] Phillip Areeda & Louis Kaplow, Antitrust Analysis, 4 (5th ed., Aspen: 1997)
[10] David S. Evans, The Antitrust Economics of Multi-Sided Platform Markets, 20 Yale J. on Reg. 325, 362 (2003).
[11] Id.
[12] Id.

Competing Definitions

The two most influential definitions of barriers to entry provide the umbrellas under which many other definitions and contributions to entry barrier jurisprudence can fit.[13]

The first of these definitions is known for its expansiveness; Joseph Bain defines barrier to entry as some factor in a market that permits incumbent firms to earn monopoly prices[14] without attracting new entry.[15] The second major definition offers a narrower view; George Stigler defines a barrier to entry as a cost of producing (at some or every rate of output) which must be borne by firms that seek to enter an industry, but is not borne by firms already in the industry.[16]

Bain coined the phrase "barriers to entry" to refer to three aspects of market structure that could prevent a new entry, even though existing prices exceeded a competitive level.[17] Those aspects of market structure that concerned Bain specifically were, "absolute cost advantages", "product differentiation" and "economies of scale."[18] An absolute cost advantage prevents entry by allowing incumbents to sell profitably at prices below the costs of potential entrants.[19] Product differentiation could prevent entry by allowing incumbents to charge higher prices than entrants and thus sell more profitably when new entrants could not.[20]

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[13] See generally, E. Thomas Sullivan & Herbert Hovenkamp, Antitrust Law, Policy and Procedure: Cases, Materials, Problems, 659 (5th ed., LexisNexis 2003); Ernest Gellhorn, William E. Kovacic & Stephen Calkins, Antitrust Law and Economics in a Nutshell, 138-140 (5th ed., West 2004).
[14] A monopoly is generally when the number of sellers is so small that each seller can influence the total supply , thus those sellers have the power to set the product's price. Campbell McConnell & Stanley Brue, Economics, 85 (14th ed. McGraw Hill 1999).
[15] Joseph S. Bain, Barriers to New Competition, 3 (1956).
[16] George Stigler, The Organization of Industry, 67 (1968).
[17] Gregory J. Werden, Network Effects and Conditions of Entry: Lessons from the Microsoft Case, 69 Antitrust L. J. 87, 98, citing Bain, supra n.6 at 53, 114, 144 (chapter headings).
[18] Id.
[19] Bain, supra n.6 at 114-120. One must wonder whether Wal-Mart meets this criteria and if it does and Bain's definition is as widely accepted as some believe, why has no regulatory agency challenged Wal-Mart as monopolistic. Put another way, with the executive branch of government changing philosophical hands, could Wal-Mart be in danger?
[20] Id. at 144-147. Product differentiation is basically the goodwill associated with a product or producer by consumers.

Economies of scale prevent entry by offering a choice between entry at a suboptimal scale with a cost disadvantage, or entry at an efficient scale with a depressing effect on prices.[21] Bain's initial study did not identify all possible barriers to entry. Later, Bain would analytically define barrier to entry as "some source of disadvantage to potential entrants as compared with established firms."[22]

Bain's definition has received wide academic support and even some broadening. For instance, "an entry barrier is any factor that permits firms already in the market to earn returns above the competitive level while deterring outsiders from entering."[23] Not surprisingly, that definition leads to including economies of scale, high initial investment, capital market imperfections, high risk, low prices, scarce inputs or customers, product reputation and promotion, and government restraints as barriers to entry.[24] Bain has also been more widely adopted by courts and enforcement agencies.[25]

Stigler's definition, and undoubtedly its resulting decreased market intervention, has received much praise from, and is associated with the "Chicago School" of law and economics.[26] Judge Posner restates Stigler's definition as "a condition that imposes higher long-run costs of production on a new entrant than are borne by the firms already in the market."[27] A barrier to entry then implies the existence of a range within which firms in a market can increase the market price above the competitive level without having to worry about losing sales to a new entrant.[28]

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21 Werden, supra n.8 citing Bain, supra n.6 at 53-56.

22 Joe S. Bain, Industrial Organization 239 (1959).

23 Phillip A. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application vol. 2A, 56-57 (West 2002).

24 Id. at 65.

25 See Sullivan & Hovenkamp, supra n.5 at 660; Gellhorn et al., supra n.5 at 139. This author would suggest the reason for Bain's definition's popularity with courts and agencies is due to the flexibility provided by such broad language. Thus, Bain allows a judge or executive branch enforcer to arrive at his desired result more easily, whereas Stigler would reduce the judicial and administrative discretion.

26 "Chicago-school" generally refers to a particular brand of economics known for adherence to a neo-classical price theory and free market libertarianism, as well as the application of economic reasoning to political theory, legal theory ("law and economics"), history and sociology. See generally, Milton Friedman, Capitalism and Freedom, (University of Chicago 1962); Richard A. Posner, The Economic Analysis of Law (3rd ed., Little, Brown 1988); Aaron Director and Edward Levi, Law and the Future: Trade Regulation, 51 Nw. U. L. Rev. 281 (1956). For Chicago School theory applied to antitrust see, Richard A. Posner, The Chicago School of Antitrust Analysis, 127 U. Pa. L. Rev. 925 (1979).

27 Richard A. Posner, Antitrust Law, 74 (2nd ed., University of Chicago 2001).

28 Id.

Entry barriers, under this definition, thus become rare outside of declining industries.[29] Posner emphasizes that in practical terms, there are a variety of conditions that may not create an actual barrier to entry but do increase the time, resources, and/or risk involved in entering a new market.[30] For example, a manufacturing process may be so complex that it would take years to perfect and/or well-compensated skilled labor to execute. These conditions do not make entry impossible but do require additional capital and time, and increase the risk associated with failure.

Judge Bork, also accepting a narrow, Chicago school, definition, delineates between natural and artificial barriers to entry, advocating for regulation of the latter only.[31] According to Bork, artificial barriers are those that are not superior forms of efficiency, yet still prevent the forces of the market.[32] For example, Wal-Mart's size would be considered a natural barrier because it is the result of increased efficiency and customer satisfaction while an exclusive dealing contract would be considered an artificial barrier to entry because it is not the result of increased efficiency but rather an arbitrary decision between 2 actors to only benefit each other.

Confusing Results

Having imported the concept of entry barriers from economics, the term has since been used hundreds of times in antitrust decisions.[33] Relatively few of those decisions have provided any indication of what is meant, and those that do are neither entirely clear nor totally consistent.[34] The Supreme Court has, on several occasions, remarked on the importance of entry into a market, but has yet to define barrier to entry.[35] Without directly defining the term, the Court's usage of barriers to entry, has shown to be more consistent with Bain's definition than with Stigler's.

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[29] Id.
[30] Id.
[31] Robert H. Bork, The Antitrust Paradox: A Policy at War with Itself 310-311 (Free Press 1978).
[32] Id.
[33] Werden, supra n.8 at 102.
[34] Id.
[35] See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 226 (1993); Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 119-120 n.15 (1986) ("without barriers to entry it would presumably be impossible to maintain supracompetitive prices for an extended time.")

For example, the Court's reasoning in several different cases indicated that an increased capital requirement placed on potential new entrants (as a result of the practices at issue) constituted an entry barrier.[36]

Decisions from the circuit courts and the Federal Trade Commission (FTC) provide a variety of approaches to entry barriers. The Tenth Circuit has defined barriers to entry as "particular characteristics of a market which impede entry by new firms into that market."[37]

It is no surprise that a Bainian definition like this led to declaring high capital costs and regulatory or legal requirements such as patents or licenses to be entry barriers.[38]

The Court of Appeals for the D.C. circuit has used both definitions. The court has affirmed a regulatory agency decision which defined barriers to entry as "those costs that a new entrant must incur that were not incurred by the incumbent" thus affirming the agency's determination of cost for rate setting purposes.[39] Previously, however, the D.C. Circuit had used a much more "Bainian" definition stating "any market condition that makes entry more costly or time consuming and thus reduces the effectiveness of potential competition as a constraint on the pricing behavior of the firm should be considered a barrier to entry."[40]

The Ninth Circuit has held that entrenched buyer preferences or company reputations can be a barrier to entry[41] as well as capital market evaluations imposing higher capital costs on a new entrant[42] and legal license.[43]

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36 Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 29 n.48 (1984)(an exclusive contract could raise entry barriers); Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451, 485 (1992)(the "tying" of one product to another makes a new entry "significantly more expensive" thus creating a barrier to entry).

37 Reazin v. Blue Cross & Blue Shield of Kansas, Inc., 899 F.2d 951, 968 (10th Cir. 1990).

38 Id. One year earlier, the 10th Circuit gave an even broader definition stating that barriers to entry are market characteristics that make it difficult or time-consuming for new firms to enter a market. Colorado Interstate Gas Co. v. Natural Gas Pipeline of Am., 885 F.2d 683, 696 n.21 (10th Cir. 1989).

39 Burlington N. R.R. Co. v. Surface Transp. Bd., 114 F.3d 206, 214 (D.C. Cir. 1997).

40 S. Pac. Comm. Co. v. AT&T, 740 F.2d 980, 1001 (D.C. Cir. 1984).

41 Image Technical Services, Inc. v. Eastman Kodak Co., 125 F.3d 1195, 1208 (9th Cir. 1997).

42 Am. Prof. Testing Services, Inc. v. Harcourt Brace Jovanovich Legal & Prof. Pubs., Inc., 108 F.3d 1147, 1154 (9th Cir. 1997).

43 Los Angeles Land Co. v. Brunswick Corp., 6 F.3d 1422, 1427-1428 (9th Cir. 1993).

However, the court also adopted a more Stiglerian approach in declaring that difficulty in obtaining financing in a particular industry is not necessarily a barrier to entry.[44]

Product reputation and promotion is an area where Stigler's narrower definition has received much more deference. For example, the Ninth Circuit specifically rejected the proposition that a competitor with a proven product and strong reputation is necessarily being anticompetitive.[45] The Ninth Circuit has also stated, "We fail to see how the existence of good will achieved through effective service is an impediment to, rather than the natural result of, competition."[46]

The Third Circuit has also stated that to find reputation to be a barrier to entry is implausible.[47]

The Second Circuit seemed also to favor a narrower view of entry barriers in *U.S. v. Waste Management.*[48] In *Waste Management*, a fifty percent market share was not illegal since the market was characterized by ease of entry.[49] This "ease of entry" argument has turned the entry barrier argument on its head and used the lack of barriers as an affirmative defense.[50] Judge Winter, no stranger to Chicago school economics, argued that a lack of frequent new entries was not evidence of entry barriers but rather evidence of competitive, entry-forestalling prices.[51] In doing so, Judge Winter relied on Supreme Court holdings that required an appraisal of a merger's effect on competition to account for potential competition from firms that were not presently active in the given market.[52]

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[44] Id. at 1428.
[45] Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1164 (9th Cir. 1997)(stating that product reputation is the essence of competition). Here the Ninth Circuit seems to be inconsistent. If product reputation is the essence of competition, how can product differentiation be a barrier to entry?
[46] U.S. v. Syufy Enterprises, 903 F.2d 659, 669 (9th Cir. 1990).
[47] Advo, Inc. v. Philadelphia Newspapers, Inc., 51 F.3d 1191, 1201-02 (3rd Cir. 1995).
[48] 743 F.2d 976 (2nd Cir. 1984).
[49] Id.
[50] See Victor Hsu, The Ease of Entry Doctrine in Merger Law: Managing the Waste of In Re Echlin, 20 Pac. L. J. 75, 79 (1988).
[51] Waste Management, 743 F.2d at 983.
[52] Id. at 982 citing U.S. v. Falstaff Brewing Corp., 410 U.S. 526 (1973); FTC v. Procter & Gamble, 386 U.S. 568 (1967); U.S. v. Penn-Olin Chem. Co., 378 U.S. 158 (1964).

Judge Winter also relied on the *Merger Guidelines* issued by the government, which "not only recognize the economic principle that ease of entry is relevant to appraising the impact upon competition of a merger but also state that it may override all other factors."[53]

As a result of *Waste Management*, ease of entry has become the automatic counter-argument to a barrier to entry argument; some have even suggested that difficulty of entry may be necessary for a prima facie case.[54] The FTC in *Echlin Manufacturing Co.*[55] made this trend toward Stigler's definition obvious. In *Echlin*, the Commission adopted the definition of "additional long run costs that must be incurred by an entrant relative to the long run costs faced by incumbent firms."[56]

In fact, the Commission went on to declare this definition to be "widely accepted in legal and economic communities."[57]

The complaint in *Echlin* argued that four barriers to entry existed: sunk costs, economies of scale, lack of significant entry in the recent past, and predatory practices.[58] The majority considered sunk costs and economies of scale to not even be barriers to entry because every entrant must face these costs.[59] An absence of recent entries might be a sign of entry barriers, or it could just as easily be a sign of fair competition.[60] Predatory practices, the Commission reasoned, is only a real barrier if accompanied by other barriers, otherwise the incumbent would never be able to recoup the costs of such a practice.[61]

Because of its detail, *Echlin* is a key case.[62] Commissioner Bailey's broad definition of barrier to entry led her to completely different results after seeing the same facts as the majority.[63]

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[53] Id. at 982 citing U.S. Dept. of Justice 1984 Merger Guidelines, 46 Antitrust & Trade Reg. Rep. (BNA) No. 1169 Spec.Supp. § 3.3, at S-6.
[54] Hsu, supra n.41 at 79.
[55] In re Echlin Manufacturing Co., 105 F.T.C. 410 (1985).
[56] Id. at 485.
[57] Id. Of course, the other side of the argument was also represented by the dissenting opinion from Commissioner Bailey who described the majority's analysis as the "Chicago school economic state religion approach to barriers to entry." Id. at 495.
[58] Id. at 484.
[59] Id. at 487-491.
[60] Id.
[61] Id. at 490.
[62] Hsu, supra n.41 at 85.
[63] Echlin, 105 F.T.C at 495.

It is also important because it illustrates how the adoption of a particular definition of barrier to entry determines the path of the analysis and ultimately, the result of the case.

Conclusion

Congress always has the option of offering a definition as part of its next piece of "competition" legislation, which would also allow the federal courts a chance to review. The Supreme Court has allowed several chances to offer a precise definition pass by. Certainly, there are advantages (and perhaps this is why the Supreme Court has skirted the direct issue) to declining to offer a simple definition. By not providing a definition, the Court avoids stepping into an innately philosophical debate. The Court also preserves for itself and lower courts, a significant amount of judicial flexibility by not offering a bright line definition.

While vague language does offer flexibility, it does not offer legal certainty. Such uncertainty is properly considered to be an additional "information" or "transaction" cost. Judge Easterbrook suggests:

When everything is relevant, nothing is dispositive. Any one factor might or might not outweigh another, or all of the others, in the fact finder's contemplation. This formula offers no help to the businesses planning their conduct. Faced with a list of such imponderables, lawyers must engage in ceaseless discovery… Litigation costs are the product of vague rules combined with high stakes.[64]

With certainty being desired, what should this certain definition look like? A distinction could be drawn between "artificial" and "natural" barriers to entry.[65] Natural barriers, such as efficiency, existing plant or equipment, skill, and/or reputation, might not be a proper concern for antitrust law.

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[64] Frank H. Easterbrook, The Limits of Antitrust, 63 Tex. L. Rev. 1, 12 (1984). An area that receives little, if any, attention from the "Law and Economics" scholars is the cost of legal certainty. Are there transaction costs inherent to a bright-line rule? If there are, they would be much more difficult to quantify and may perhaps be best categorized as "social" costs. For example, a bright-line rule may be efficient and just 90% of the time but there may be a situation where strict application of the rule may result in inequity thus leaving at least one innocent economic actor with no legal recourse. Could this dissuade a potential entrant?

[65] Bork, supra n.22 at 310-329.

As a policy matter, it seems that efficiency and skill ought to be rewarded with its natural spoils rather than restraint. To remove the incentive to improve from a firm that has reached a certain level of efficiency would harm the consumer in that prices could be lower and/or delivery could be quicker or more convenient. It seems impossible to consider reputation or advertising and promotion as a barrier to entry. Protecting the goodwill a firm has earned in the marketplace is the entire point of trademark and unfair competition law.[66] Market-based competition is based on product differentiation; this is what inspires innovations in products and services. High capital requirements are also a natural barrier. Although a large amount of capital may be needed to enter the aircraft manufacturing business, those who are already in the market were, at there own particular time of entry, required to "ante up" in much the same way.

Artificial barriers to entry, those which are not forms of superior efficiency but still prevent the forces of the market, should receive considerable attention and regulation from antitrust law.[67] For example, the most notable artificial barrier to entry of late is the "product tying" by Microsoft. By linking the use of 2 separate products (in this case, tying use of its Internet Explorer to the use of a Microsoft operating system), Microsoft has caused an artificial barrier to entry for those trying to enter the internet browser market.[68] It should be noted that government is probably the leading provider of artificial barriers to entry.[69] Judge Bork seems to imply that these barriers should be eliminated or at least regulated. But in many situations, it is regulation itself that is the barrier. Inefficient or not, no reasonable politician in the executive or legislative branch is going to be calling for the removal of medical boards, the bar exam, or telecom licenses because they are artificial barriers to entry. The problem with this distinction and its resulting definition of barriers to entry is that it would inevitably require a certain amount of economic literacy in jurists.[70]

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[66] See generally, Hanover Star Milling Co. v. Metcalf, 240 U.S. 403 (1916) (stating that the redress that is accorded in trademark cases is based upon the party's right to be protected in the goodwill of a trade or business).

[67] See Bork, supra n.22 at 311.

[68] See generally, Mark Geier, U.S. v. Microsoft Corp., 16 Berkeley Tech. L. J. 297 (2001).

[69] For example, Intellectual Property law (especially patents) allows a firm to lock up use of a product for a limited period of time. Governments also supply other restrictions such as zoning laws, licenses and insurance requirements. These may be wise from a public policy perspective and they may be a reflection of the type of society we have chosen to live in, however they are artificial barriers in that they did not result from increased efficiency.

[70] For instance, one sign of a monopolized market is an inelastic demand curve. Leaving judges (or economists for that matter) to determine how elastic a firm's demand curve is could prove overwhelming and fail to move us any closer to a bright line definition.

And although Bork adds to the discussion with this distinction, it leaves antitrust law no closer to a predictable definition and legal certainty.

One interesting side note in all of this is what a lack of recent entries into a market means? This question was a point of contention in *Echlin*.[71] Commissioner Bailey reasoned that some factor (entry barriers) must be making the market unattractive.[72] In fact, she stated that evaluation of the historical record is the easiest and most practical way to assess whether barriers to entry exist.[73] While it does provide a simple solution, this method does not provide an accurate picture nor an adequate solution. There can be any number of reasons a firm or entrepreneur decides against a particular industry. For instance, the idea of entry into a particular market may not occur to a firm because that market has caused them no problems. In other words, people have bought or sold in that market at what they deemed to be fair prices and quality and have not thought twice about that market.

The importance of the concept of barriers to entry seems to be growing in antitrust jurisprudence.[74] In the end, Stigler's definition, or something similar, seems preferable. This author suggests two situations where legal intervention would be necessary: first, if the long-run costs of a new entrant are higher than those of existing firms in a market, legal intervention may be necessary; second, existing firms in the market have pricing power over the entire market (however broadly or narrowly that market is defined). If there is no pricing power, there is no barrier.[75] If it is the consumer that we are worried about, then pricing power seems to be the obvious evil for which regulators should be offering a remedy. A broader definition allows for unnecessary regulation and increased costs without any real proof of benefit to the consumer. In any case, certainty is desired. If the goal is to increase efficiency and ultimately, consumer well being, a certain, predictable definition must be offered.

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[71] Echlin, 105 F.T.C. at 493.

[72] Id. at 500.

[73] Id. at 498.

[74] See generally, David L. White, Shaping Antitrust Enforcement: Greater Emphasis on Barriers to Entry, 1989 B.Y.U. L. Rev. 823 (1989).

[75] Put another way, when $MR \neq MC$ there likely exists some kind of entry barrier. This conception may move us somewhat closer to a bright line rule but still seems more difficult to measure than Stigler's entry barriers.