SORTING THE COLLUSIVE GOATS FROM THE CONSCIOUSLY PARALLEL SHEEP

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Tacit collusion refers to the process by which competitors in a concentrated market effectively coordinate their pricing and output decisions to achieve prices above the competitive level without any communicated understanding among them. From the point of view of antitrust policy, tacit collusion is undesirable, because it leads to reduced output and harm to consumers as compared to the competitive outcome.

The Supreme Court, in declaring that tacit collusion is "not in itself unlawful," noted that tacit collusion is "sometimes called oligopolistic price coordination or conscious parallelism."[2] In my view, "oligopolistic price coordination," while more of a mouthful, is the better term, at least for lawyers. For one thing, it is more precise – it concisely describes coordinated price-setting in an oligopolistic industry. For another, it avoids confusion – because collusion that is tacit in the sense of "non-verbal" is unlawful if it involves actual agreement (a wink and a nod). But I will stick with "tacit collusion" for purposes of this comment.

On the other hand, "conscious parallelism" is a term that is too inclusive to serve as an apt synonym for tacit collusion. Pricing that is the product of tacit collusion is consciously parallel, but not all pricing that is consciously parallel constitutes tacit collusion in the sense described above. The purpose of this comment is to illustrate the difference by reference to two widely cited Seventh Circuit antitrust opinions, both authored by Judge Posner, *In re High Fructose Corn Syrup Antitrust Litigation*,[3] ("*HFCS*") and *In re Text Messaging Antitrust Litigation*,[4] ("*Text Messaging*"). My argument is that although *HFCS* involved collusive pricing in the broad sense – that is, it was the product of either lawful oligopolistic price coordination or unlawful express collusion – *Text Messaging* did not.

My initial interest in comparing the two cases arose from Judge Posner's change of position – in his academic writing – on the question whether tacit collusion should be lawful in the first place. As Greg Werden recounts in his excellent article on oligopoly pricing and game theory (helpfully simplified for lawyers like me), for a period in the middle of the 20th Century, there was doubt about whether, in some circumstances, coordinated conduct might give rise to liability in the absence of spoken agreement.[5] But the Supreme Court's decision in *Theatre Enterprises*,[6] and a 1962 article by Donald Turner – the leading antitrust authority of the time – laid those doubts to rest. Prof. Turner's article concluded that, although oligopolistic price coordination, as a matter of statutory language, might satisfy the concerted action requirement of Section 1 of the Sherman Act, no remedy was possible for conduct that reflects rational, interdependent – but unilateral – conduct.[7]

When still an associate professor at Stanford, Richard Posner published an influential article in which, taking on Prof. Turner, he proposed that tacit collusion should be actionable as a violation of Section 1.[8] In his academic writing, Judge Posner maintained that view for decades.[9] So matters stood when, in 2013, Prof. Louis Kaplow published *Competition Policy and Price Fixing*, a book intended "to provide an analytical foundation for designing policy towards coordinated price elevation in oligopolistic industries."[10] Like Prof. Posner, Prof. Kaplow argued that the economic effects of conduct – and not a "formalism" related to the nature of communication employed to bring those effects about – should govern the legal response to that conduct. In his preface, Prof. Kaplow singled out Judge Posner's 1969 article, noting that "the spirit of his argument as well as some key insights provide invaluable illumination."[11] Having such distinguished company was apparently too much for Judge Posner,

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2 See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227 (1993).

3 295 F.3d 651 (7th Cir. 2002).

4 782 F.3d 867 (7th Cir. 2015). The Seventh Circuit's decision in *Text Messaging* was preceded by an earlier opinion affirming, on interlocutory appeal, the district court's denial of a motion to dismiss the complaint for failure to state a plausible antitrust claim under *Twombly*. See *In re Text Messaging Antitrust Litig.*, 630 F.3d 622, 629 (7th Cir. 2010). The author represented Verizon throughout the litigation.

5 Werden, "Economic Evidence of Collusion: Reconciling Antitrust Law with Oligopoly Theory," 71 Antitrust L.J. 719, 739-745 (2004).

6 *Theatre Enters., Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537 (1954).

7 Turner, "The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals To Deal," 75 Harv. L. Rev. 655 (1962).

8 Posner, "Oligopoly and the Antitrust Laws: A Suggested Approach," 21 Stan. L. Rev. 1562 (1969). Posner takes issue with Turner on two basic grounds. First, work by the economist George Stigler (published after Turner's article) showed, contrary to the view of some earlier economists, that arriving at the monopoly price was not the necessary result of rational price setting in an oligopoly – in other words, collusive pricing might not be so likely in the absence of express agreement as had been believed. Second, Posner believed that the remedial problem was not as intractable as Turner had believed.

9 See, e.g. Posner, *Antitrust Law* 51-100 (2d ed. 2001).

10 Kaplow, *Competition Policy and Price Fixing* 1 (2013).

11 Id. xv.

who promptly changed his mind, and decided that Prof. Turner had been right all along: tacit collusion, because it defies effective remediation, should not be treated as unlawful.[12]

It would be a mistake to confuse the views of Richard Posner with the law of the Seventh Circuit as laid down in the Court's opinions – even (or perhaps especially, since the temptation is greatest) in those cases where he was the author. But it is interesting that in *HFCS*, the Court went out of its way to note that the language of Section 1 "is broad enough . . . to encompass a purely tacit agreement to fix prices." (Though the opinion emphasized that "an express, manifested agreement, and thus an agreement involving actual, verbalized communication, must be proved in order for a price-fixing conspiracy to be actionable under the Sherman Act."[13]) By contrast, in *Text Messaging*, the Court explained – in terms familiar to readers of Judge Posner's academic writing – that Prof. Kaplow's view that "tacit collusion should be deemed a violation of the Sherman Act" is "not the law, and probably shouldn't be."[14] Moreover, in *HFCS*, the Court reversed summary judgment in favor of defendants, while in *Text Messaging* it affirmed it.

But in comparing the two cases more closely, it became clear that the claims in *Text Messaging* were substantially weaker than the claims in *HFCS* in ways that the later opinion does not fully acknowledge.[15] In the earlier case, producers of HFCS – including ADM, which had earlier been convicted of fixing prices for lysine – were accused of price-fixing. There appeared to be no serious dispute that the pricing at issue in *HFCS* was the product of oligopolistic coordination,[16] whether lawful (tacit) or unlawful (express). By contrast, in *Text Messaging*, wireless carriers were not accused of fixing prices of wireless service generally; rather, they were accused of fixing the price of text messages paid for individually – "pay-per-use" ("PPU") text messages. But the pricing of PPU in *Text Messaging*, while uniform, was not collusive.

In this regard, it is important to recognize that not all parallel conduct constitutes tacit collusion. For one thing, if all of the sellers in a competitive market raise their prices in response to an increase in demand or input costs, such an increase – though it would appear lockstep – would reflect competitive behavior. One might properly respond that such parallel conduct is not *consciously* parallel in the relevant sense: a seller in a competitive market (who is already selling at cost) confronted with an increase in marginal cost will increase prices to recover those costs – whatever its rivals may do.

But even consciously parallel conduct need not be collusive in the relevant sense, because it may not reflect any "shar[ing] of monopoly power."[17] In a commodity market, parallel price increases (or output restrictions) unjustified by increased cost or other market conditions are "collusive" in the sense that they are unsustainable without collective action (whether or not the action results from agreement). If there are five sellers in the market selling identical goods, each with spare capacity, and seller A increases its price, sellers B-E will capture a portion of its sales as long as they decline to follow the increase (and seller A will have to retract the increase). But if sellers B, C, D, and E quickly join seller A, the price increase will succeed. It is that joining – not compelled by market conditions but intended instead simply to boost profits – that one can call

12 See Posner, *Economic Analysis of Law* § 10.2 (9th ed. 2013); Posner, "Review of Kaplow, *Competition Policy and Price Fixing*," 79 Antitrust L.J. 761 (2014). Assuming that purely unilateral oligopolistic price coordination should not be unlawful begs at least two harder questions. First, what sort of facilitating practices should be subject to condemnation in an oligopolistic industry when they have the effect of allowing competitors to maintain higher prices? For a skeptical view, see Carlton, Gertner & Rosenfield, "Communication Among Competitors: Game Theory and Antitrust," 5 Geo. Mason L. Rev. 423 (1997). Second, how hard should it be to infer an agreement based on circumstantial evidence? Under Supreme Court precedent, a plaintiff seeking to survive summary judgment on a claim that defendants have conspired in violation of Section 1 is required to proffer "evidence 'that tends to exclude the possibility' that the alleged conspirators acted independently." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986). Whether evidence has such a "tendency" depends at least in part on how difficult it is for competitors to maintain supra-competitive pricing without an express understanding – a question that game theory can help to address but that is, in the end, empirical. A court interpreting the *Matsushita* standard should also pay attention to the cost of false positives and false negatives – can the threat of liability encourage rivals to compete more vigorously, which would seem to be a good thing? Or could the threat of liability discourage entry, as Judge Posner has worried?

13 Id. at 654.

14 782 F.3d at 874.

15 Although *Text Messaging* does not cite *HFCS*, the Court's prior opinion did. See 630 F.3d at 629.

16 See *HFCS*, 295 F.3d at 661 ("[T]here is evidence that the defendants were not competing; we might go so far as to say that they had tacitly agreed not to compete, or at least to compete as little as possible.").

17 *Brooke Group*, 509 U.S. at 227.

the "acceptance" of seller A's price-increase "offer."[18] The price increase reflects tacit collusion (assuming no express agreement) because it is the uniformity of action that gives the price increase market-wide effect (and harms consumers).

On the other hand, the mere fact that one seller imitates another seller's *successful* strategy doesn't suggest anything that can be called collusion. Take the example that the Court offered in *Text Messaging*:

> Competitors in concentrated markets watch each other like hawks. Think of what happens in the airline industry, where costs are to a significant degree a function of fuel prices, when those prices rise. Suppose one airline thinks of and implements a method for raising its profit margin that it expects will have a less negative impact on ticket sales than an increase in ticket prices – such as a checked-bag fee or a reservation-change fee or a reduction in meals or an increase in the number of miles one needs in order to earn a free ticket. The airline's competitors will monitor carefully the effects of the airline's response to the higher fuel prices afflicting the industry and may well decide to copy the response should the responder's response turn out to have increased its profits.

That is certainly right, but that copying cannot be accurately described as collusive because (at least as far as the hypothetical indicates) the success of the pricing change does not depend on whether competitors follow. It will instead depend on whether the airline has discovered an effective way to price-discriminate among its customers. Consider the checked-bag fee: the airline may have a pretty good idea that 20 percent of passengers will have to check a bag on a particular route. If the airline institutes a check-bag fee of $25, that will allow it to reduce the price of a ticket by $5 for everyone on the plane without sacrificing any revenue. Of course, the 20 percent of customers that check a bag will pay more – $20 more per ticket – but if passengers with checked luggage also tend to be less price elastic than those without checked luggage, the change in pricing structure will be a winner, because fewer customers will be lost than gained.

A competitor (say, Airline B), seeing the success of Airline A, will imitate the strategy. But Airline A (assuming the new pricing structure is working) does not care whether Airline B adopts it as well – it might even prefer that Airline B stick to its free-bag policy. To be sure, for the 20 percent of customers with bags, Airline B will be at a price advantage, but for the other 80 percent Airline A will be at an advantage. Moreover, if there are costs associated with checked baggage (as, presumably, there are), Airline B will be stuck with the bags, and Airline A will be blessed with bag-less flyers. If Airline B follows, Airline A would maintain the strategy – it is a better pricing structure for the reasons described, irrespective of what Airline B does – but it would lose the *competitive* advantage that the checked-bag fee confers.

Moreover, at least in the Court's hypothetical, it is not the case that the success of the checked-bag fee depends on competitors' response: Airline B copied Airline A only once it observed that the strategy was working. In the price-increase scenario, by contrast, the success of the price increase *depends* on competitors' response – seller A can sell at a higher price only if sellers B-E increase their prices as well. That is why the increase reflects *coordinated* pricing – it depends on rivals recognizing their joint interest in forgoing profitable sales to achieve a price increase.

The parallel increase in PPU prices at issue in *Text Messaging* did not reflect tacit collusion – indeed, the Court's opinion makes that clear (though it does not address the point). PPU text messages are not like HFCS – they are not a commodity and cannot be purchased on their own. Instead, PPU text messages are one service feature available to wireless subscribers. An increase in the PPU price is like the airlines' checked-bag fee – it provides a way for carriers to obtain some extra revenue from a discrete set of customers. And like the airline that institutes a checked-bag fee, a carrier in a competitive market can use the extra revenue to reduce other prices (say, the basic subscription rate) that more customers care about (and care more about).[19]

As the Court explained, there were additional reasons that increasing the PPU rate was a profitable strategy, none having to do with coordination. For one thing, at a time of increasing use of text messaging, a carrier might predict that an increase in the PPU rate would encourage customers to subscribe to a bundle of text messages (say, 100, 1000, or an unlimited number for a monthly fixed fee), and carriers "*wanted* their PPU customers to switch to bundles."[20] By the same token, "as price-sensitive users moved off PPU to bundles, . . . the overall demand for PPU became less elastic, meaning that a given percentage increase in the price of PPU service had a smaller negative effect on the demand for the

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18 *HFCS*, 295 F.3d at 654.

19 *Cf.* 782 F.3d at 878 ("[S]ince an agreement to fix prices in the PPU market would have left the carriers free to cut prices on the bulk of their business (for they are not accused of fixing bundle prices), the slight gains from fixing PPU prices would be negated by increased competition in the carriers' other markets.").

20 782 F.3d at 877.

service. That made raising the PPU [rate] a revenue winner."[21]

Plaintiffs argued that carriers would not increase prices without agreement because customers subject to the increase would switch carriers, but that argument had no evidence to support it. As the Court noted, "the four defendants in this case did not move in lockstep" and "during most of the entire period at issue . . . T-Mobile's PPU was 5 cents below Sprint's."[22] If that difference caused churn, there should have been evidence of it, and there was not: as a T-Mobile executive put it, "[F]or having the lowest messaging rates on the planet, we are not necessarily receiving a more favorable share of the market."[23] "A company that stands to lose some PPU customers because of a price increase may be confident that they will not abandon the company for another but instead sign on to the company's text messaging bundle plan. Put differently, there is no evidence that PPU pricing is a major determinant of consumers' choice of carrier."[24]

It thus follows that the first wireless carrier to raise its PPU rate would have been just as happy (perhaps happier) if none of its rival carriers had adopted the same increase – the PPU price increase was a winning strategy without coordination.[25] The Court referred to this argument as "overkill" because "it is not a violation of antitrust law for a firm to raise its price, counting on its competition to do likewise."[26] But the argument matters not because coordinated price increases are unlawful, but because if the success of the PPU increase did not depend on "its competition [doing] likewise," the carriers had no reason to coordinate – a point that the Court itself recognized.[27] And the fact that "[one carrier] held back . . . fearing that [another carrier's] increase would have a bad effect,"[28] is likewise not the behavior one would expect in the presence of collusion, where competitors raise prices because of an agreement (tacit or express) to do so, even though a price increase by a single seller would be unprofitable.

The idea that adoption of a discriminatory pricing structure often reflects competitive pressure, not collusion, is the basic insight of Baumol and Swanson's 2003 article, "The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power."[29] They noted that businesses that have economies of scale must adopt prices "that are discriminatory and exceed marginal costs," and that "it is competition, rather than its absence, that in many cases serves to impose discriminatory pricing."[30] That is true for wireless carriers – if a carrier finds a pricing structure that allows it to recover costs from customers who are price inelastic, that will give that carrier a competitive advantage. And competition (not lack of competition) will impel rivals to copy that structure. Such behavior is consciously parallel. But it is not collusive.

21 Id. at 878.

22 Id. at 877.

23 Id. (alteration in original; internal quotation marks omitted).

24 Id.

25 It is true that the first carrier to increase its rate from $0.15 to $0.20 did not adopt that increase until its rivals had increased their rates to $0.15. My instinct is that the success of the second price increase did not depend on that fact, but if it did, then the price increases were more interdependent than the discussion in text suggests. Needless to say, in the real world businesses may be at least as concerned about bad publicity as the shape of the demand curve.

26 782 F.3d at 876.

27 Id. at 878 ("[I]f the carriers were going to agree to fix prices, they wouldn't have fixed their PPU prices.").

28 Id.

29 70 Antitrust L.J. 661 (2003).

30 Id. at 662.