Commodity Exchanges and Antitrust

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I. INTRODUCTION

Historically, commodity exchanges have been viewed as natural monopolies, not subject to competitive forces. But in recent years, both technology and regulatory changes have allowed for competition between rival exchanges in various contracts. With competition comes the regulation of competition, and the traditional method of regulating competition is through court adjudication of the Sherman Antitrust Act. But in regulated industries, antitrust authority must be shared in some way with the regulatory authority, and implemented by the relevant government entity.

This article will explore the impact of competition on this industry and how the exchanges are dealing with the resulting antitrust issues. Not surprisingly, there have been several allegations of anticompetitive activity in violation of the antitrust laws of the United States. Indeed, at least two lawsuits have been filed, and one complaint has been brought to the Commodity Futures Trading Commission ("CFTC"). We will discuss these three cases below.

In Section II of this paper we review the economics of commodity exchanges, and the nature of competition between exchanges. Section III examines the new forces for competition in exchanges offering commodity contracts. In Section IV, we review the basic economic and legal foundations of antitrust law. Section V provides an analysis of the antitrust mandate of the CFTC and examines the legal doctrine of implied immunity as it applies to the CFTC. Section VI discusses various types of antitrust cases, and applies these legal and economic theories to the recent cases of United States Futures Exchange, L.L.C. v. Board of Trade of the City of Chicago and the Chicago Mercantile Exchange, No. 1:04cv6756 (N.D. Illinois), New York Mercantile Exchange v. Intercontinental Exchange, Inc., No. 02-Civ-9277 (S.D.N.Y.), and Chicago Mercantile Exchange Rule 432.D Interpretation, Submission No. 04-61a, a challenge by the London International Financial Futures Exchange before the CFTC. Section VII contains our conclusions.

1. The following abbreviations will be used for the exchanges: United States Futures Exchange, L.L.C. ("Eurex US"), Board of Trade of the City of Chicago ("CBOT"), Chicago Mercantile Exchange ("CME"), Intercontinental Exchange, Inc. ("ICE"), New York Mercantile Exchange ("NYMEX") and the London International Financial Futures Exchange ("LIFFE"). A proposed merger between CBOT and CME was announced on October 17, 2006. As additional exchanges are mentioned in this article, the respective abbreviations will be noted in the text.
II. AN INTRODUCTION TO THE ECONOMICS OF COMMODITY EXCHANGES

Any discussion of antitrust issues between commodity exchanges requires a discussion of what role commodity exchanges play in the economy, how such exchanges operate, and the implications those factors have on competition between exchanges. In this section we will review these topics.

A. What Do Commodity Exchanges Do?

Commodity exchanges trade contracts, generally known as “derivatives.” Derivatives are generally divided into two categories, “futures” and “options.” Futures contracts are promises to deliver economic goods (generally agricultural products or financial claims) at a fixed price, place and point in the future. Options contracts represent the opportunity to buy or sell products at a fixed price at a fixed time and place in the future.²

Derivative contracts exist to reduce risk to economic participants. Take, for example, a farmer who is planting wheat in the spring for harvest in the fall. This farmer does not know what the price of wheat will be in the fall, and therefore, absent a futures contract, is engaged in a highly risky endeavor. If, however, that farmer can sell (“go short”) a futures contract on her crop for a fixed price for a fall delivery, then that farmer can alleviate the price risk to farming. Similarly, one can imagine how a baker who uses wheat would face a similar problem in planning his fall operations. This baker would alleviate his price risk on wheat by buying a futures contract (“going long”).³

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In the 19th century the practice of trading in futures contracts led to the development of recognized exchanges or boards of trade. At such exchanges standardized agreements covering specific quantities of graded agricultural commodities to be delivered during specified months in the future were bought and sold pursuant to rules developed by the traders themselves. Necessarily the commodities subject to such contracts were fungible. For an active market in the contracts to develop, it also was essential that the contracts themselves be fungible. The exchanges therefore developed standard terms describing the quantity and quality of the commodity, the time and place of delivery, and the method of payment; the only variable was price. The purchase or sale of a futures contract on an exchange is therefore motivated by a single factor—the opportunity to make a profit (or to minimize the risk of loss) from a change in the market price.

See also What is a Futures Exchange?, http://www.cme.com/edu/course/intro/whtfutrx9699.html (last visited October 8, 2006):
A futures exchange, legally known in the U.S. as a ‘designated contract market,’ is, at its core, an auction market—highly regulated, technical and complex—but an auction market nonetheless. A futures exchange is the only place where futures and options on futures (which offer the right, but not the obligation, to buy or sell an underlying futures contract at a particular price) can be traded. Trading may take place either on the exchange’s trading floor or via an electronic trading platform.


³ For an in depth discussion of why firms use derivatives, see Christopher Geczy et al., Why Firms Use Currency Derivatives, 52 J. Fin. 1323 (1997).
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"forward."\(^4\)

For our hypothetical farmer and baker, however, creating this forward contract may not be easy. The seller of the contract (the farmer) and the buyer (the baker) must be able to find out the existence of each other. Moreover, they must be assured that the other will not renege on their agreements. Let us assume, for example, that our farmer and baker agree to a fall contract with the purchase price of $3.00 a bushel. If, in the fall, the price of wheat is $8.00 a bushel, then the farmer has strong incentives to renege on the deal and sell her wheat elsewhere, and the baker may have little recourse.

Herein lies the role of commodity exchange. A commodity exchange creates a standardized contract, a “future” (or “option”) for a particular derivative. Such a contract describes the product involved, the time of delivery or expiration, and has attached to it a variety of financial conditions designed to deter contract default. Contracts of market participants are with the exchange, rather than with each other. When a farmer sells a future to a baker, each party has a contract, not with each other, but with the exchange. The exchange then guarantees payment on each contract to the contract holders. Thus, instead of the farmer having an obligation to the baker, as in the forward contract, through a futures contract, the exchange itself has an obligation to the baker.

The fact that the exchange holds one side of each contract obligation is an important feature in that it serves to make contracts fungible. Assume, for example, that our farmer wishes to eliminate her short position in wheat. Without a commodity exchange, she would have to go back to the baker and renegotiate. In the world of exchanges, however, there is no such requirement. Instead, the farmer can eliminate her short position on the exchange, which essentially eliminates her obligation with the exchange, by simply buying (again, “going long”) a contract equal in size to her short position.

By creating futures contracts, exchanges enable derivatives to be traded at a low cost. Exchanges create standard contract conditions which reduce contracting costs. They act as contract guarantors, thus enabling parties to make trades with assurance that the promised payoffs will actually occur. Exchanges make such contracts fungible and therefore “liquid” by holding the contracts of the participants. Additionally, exchanges provide central locations for the trade of particular contracts. Thus, if our farmer wants to go long or short in a wheat contract, she knows where to look for a party to take the corresponding side of the contract.

Because the exchange holds the contract with both parties, it must take great efforts to insure that neither party reneges with it. This process is known as “clearing,” through institutions known as “clearinghouses.” And all

\(^4\) The discussion in this section is taken from DON M. CHANCE, AN INTRODUCTION TO DERIVATIVES AND RISK MANAGEMENT 270-78 (2004).
commodity exchanges are required under the Commodity Exchange Act to have a clearinghouse in place prior to approval as a Designated Contract Market.⁵

Clearinghouses essentially perform the financial processing involved in the mechanics of exchange transactions. They confirm that each trade is acknowledged, settle the amounts owed, and ensure the financial integrity of the futures and options contracts traded on the exchanges by taking over the counterparty risk and guaranteeing that all contracts will clear on the date of performance. These services ultimately reduce the credit risk exposure of buyers and sellers and allow for exchanges to operate more efficiently.

Thus far in this discussion, it has been the implicit assumption that many or most derivative contracts would be held until their expiration; however, this is generally not the case. In fact, the vast majority of contracts are closed out before they reach expiration.⁶ The reason for this is that a firm’s risk exposure changes constantly, implying that their desired position in various derivative contracts changes constantly.

Commodities bought and sold on exchanges are not generally delivered, and instead, longs and shorts typically cash out their positions prior to the delivery (settlement) dates. Also, because each party’s position is “marked to market” each day, the importance of clearinghouse operations to exchanges increases. For example, assume on September 1 Party 1 buys 1000 units of natural gas, deliverable on October 1, at a price of $4 per unit. If by September 20, the price of natural gas has fallen to $3.25 per unit and Party 1 decides to cash out of its position, she will lose 1000*$0.75, or $750. In the commodities world, however, Party 1 would not pay $4 per unit up front, and take a loss of $0.75 on September 20. Rather, each party’s position is “marked to market” each day, meaning, the value assigned a given position is based on the current market price for that day. For example, assume on September 3, the price of natural gas fell $0.10 per unit. The clearinghouse would then take 1000*$0.10, or $100 from Party 1’s account at the exchange.

Marking to market is done to avoid credit problems at an exchange. Rather than parties who have losses paying them all upon settlement, parties pay losses as they occur, and parties who cannot meet their daily obligations have their positions closed. Because this process reduces the financial exposes of the exchange on a daily basis, it therefore reduces the overall threat of insolvency through customer default to the exchange.

Historically in the U.S., there have been three important commodity exchanges. Each of the “big three” initially started in agricultural products and eventually migrated to more complex financial instruments. The first exchange,

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the Chicago Board of Trade ("CBOT") historically specialized in grains (corn, soybeans, wheat, oats, etc.). But over the past twenty years, the CBOT has diversified its product set to include, among other things, treasury futures, as well as metals and stock indices (i.e., Dow Jones indices). The Chicago Mercantile Exchange ("CME") initially started as the Butter and Egg Board and later evolved with a specialty in meats (pork bellies, live cattle, lean hogs, etc.). And similar to CBOT, the CME has more recently moved into a diverse group of products including stock indices (i.e., S&P and NASDAQ indices) and interest rate products (e.g., Eurodollars), as well as foreign currency. Finally, the New York Mercantile Exchange ("NYMEX") has traded a variety of products, including potatoes, through its 133-year history; however, its current focus is on energy and metals products, such as crude oil, natural gas and gold.

B. In Exchanges, Liquidity is King

The need to change positions and the resulting desire to cash out positions constantly generates a tremendous desire by contract participants for "liquidity." As Harris puts it, "liquidity is the ability to trade large size quickly, at low cost, when you want to trade. It is the most important characteristic of well-functioning markets." Harris breaks down liquidity into three components: 1) immediacy, in how quickly you can make trades of a given size at a given cost; 2) width, in the cost of making a trade of a given size; and 3) depth, in the size of the trade that can be arranged at a given cost.

A discussion of "order books" illuminates Harris's theory. Order books are the standing "limit orders" or outstanding offers to buy or sell a given contract at a given time. Let us assume that the order book to buy wheat futures looks as outlined in Table 1, below.

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8. See The Chicago Board of Trade, supra note 7.
10. See id.
13. Id. at 398.
14. Today, the order books for most well-traded stocks are easily available from Yahoo.com, among other sources.
Assume that our hypothetical baker would like to reduce his “long” position in wheat by selling 400 contracts. The table above implies that the baker could sell 400 contracts, but she could only do so at what may constitute a substantial price slippage. Selling 400 contracts would require selling 100 at a price of $3.00, 200 at a price of $2.96, and 100 at a price of $2.94. This represents a price slippage of six cents from the “top” of the order book. Generally, the amount of the slippage is governed by the “width” of the order book (how much is offered at a particular price) and the “depth” (what prices are available).

Alternatively, our baker could wait for better prices by placing a “limit order” to sell his 400 contracts at a price of, say $3.05. How long the baker could expect to wait to have his order filled (if it is filled at all) is what Harris refers to as “immediacy.” Immediacy is important, because as risk changes, firms do not wish to be caught holding their previously optimal portfolios.

All of these factors—immediacy, depth, and width—are a function of the number of traders involved in a particular market. The more traders there are, the more limit orders on the order book, the wider and deeper the market, and thereby the less the price slippage is. Also, if the trader decides to wait for a better price, the more traders there are, the faster that trader is likely to get his requested price. Overall, the more trades there are, the greater the volume, the “thicker” the order book, the more immediate the transactions, and ultimately, the more liquid the market is. In this way, as a market gets larger, its value to traders improves, and this has important consequences for the nature of competition between exchanges.

C. Competition for the Market

In commodity markets, the bigger (i.e. the more traded) the contract is, the better. This leads to great difficulty in establishing new contracts to compete in these markets. Contracts generally have a variety of product attributes—such as (i) what commodity is being traded; (ii) what size of the commodity constitutes a contract; (iii) what type of price movement is allowed for the contract, which
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corresponds to the economic value of the contract (i.e., how much value is associated with a “tick”); (iv) where is the contract cleared; (v) what is the margin required to trade the product; (vi) what are the price limits for the contracts (i.e., daily highs & lows); (vii) what reporting levels are in place for the contract (known as “Large Trader Reporting” that requires traders who hold certain large positions to report to the CFTC); and (viii) how the product is traded (e.g. open outcry “in the pits,” or electronically through dedicated networks and/or the Internet).

But one crucial aspect of any contract is liquidity and the benefits derived from such. It is near impossible for a new contract to have the liquidity of an existing contract in the same product. Additionally, it is very difficult for two competing contracts to survive in the long run, competition between contracts offered by different exchanges is essentially a competition for the market. If an exchange can compete effectively for markets, then the contract with the best product attributes will survive in the long run. At that time, the operators of the surviving contract will be constrained, not by existing rivals, but by “potential” competitors (i.e., firms with the ability to enter the market if the incumbent attempts to exercise market power). It is this competition for the market with which antitrust in commodity exchanges is largely concerned. That said, it follows that the creation of barriers to entry for new competitors will be at the center of antitrust claims in this area.

III. NEW FORCES FOR COMPETITION BETWEEN EXCHANGES

With the advent of new technology, globalization, and the passage of the Commodity Futures Modernization Act (“CFMA”) of 2000, significant competition at the exchange level was introduced for the first time in the

15. The transition from open outcry to electronic trading is not always an easy process. Electronic trading is considered more transparent, efficient, and cheap as compared to open outcry. However, despite the obvious business reasons for such a transition to electronic trading, there are imbedded interests in open outcry that stall electronic progress. The lack of transparency and efficiency benefits the traders who stand “in the pits.” That is, they are able to respond to market forces “in person” before anyone that trades outside of the exchange, e.g., a trader who has to “call in” orders to a broker (who then, in turn, trades on behalf of the client). See generally The Man Versus Machine Debate, http://www.ftmandate.com/news/fullstory.php/aid/851/The_man_versus_machine_debate.html (last visited Oct. 8, 2006). In an interview with one of the authors regarding the transition to electronic trading in the Brent Crude Oil contract at the International Petroleum Exchange (“IPE”), a trader working for a large oil company stated that he/she did not want to see the IPE “go electronic” because the company liked the control it had over the market when it was run as open outcry. Further, he/she stated that the company feared that the democratization that electronic trading would bring to the market. This, in turn, would hurt the company’s interests and ability to control the market. We note, however, that one argument against electronic exchanges is that they are prone to “fat finger” errors where a trader mistakenly trades a far larger amount than he or she intended. See Bahattin Buyukshahin & Michael S. Haigh, Error Trades in Futures Markets (Commodity Futures Trading Comm’n, Working Paper, Jan. 2007).

history of the United States derivatives industry. These three recognizable forces have worked to reduce the barriers to entry to becoming an exchange.

A. "Let's be Gentlemen"—The Rules of Exchange Competition Prior to the Commodity Futures Modernization Act of 2000

Competition between futures exchanges within the United States before the Commodity Futures Modernization Act of 2000 has been described by market observers as “historically mild.” As has been traditionally the case: “[t]he Chicago exchanges have competed in the past over new products, with one market eventually emerging as the dominant market, and the other market relinquishing that listing as a result. CBOT trades the mini-Eurodollar, which competes with the CME. But the competition between the two exchanges has generally been healthy and good-natured.”

Other commentators note that the exchanges entered into an implicit "gentlemen’s agreement," whereby they agreed to not compete in each other’s dominant markets. As one commentator put it:

The Chicago Merc and CBOT are thriving, in part, by following a sort of gentlemen’s agreement to respect each other’s traditional business turf. The CBOT specializes in futures contracts tied to such storable commodities as corn and soybeans, as well as long-term interest rates. The Chicago Merc specializes in perishable commodities such as live cattle and hogs, as well as in short-term interest rates.

This “respect for competition” has led to the development of exchange franchises in successful contracts. That is, once a product gains traction and liquidity, other exchanges in the United States will not pursue the contract. While one could assume that this “gentlemen’s agreement” is responsible for the lack of competition in successful contracts, difficulty in “stealing” a successful contract from the incumbent exchange is another plausible explanation. If stealing an established contract is nearly impossible, competing exchanges may decide that they would rather invest their resources elsewhere. According to Damgard:

18. Id. at 8.
20. Not surprisingly, at least one high-ranking official from a U.S. exchange, the CBOT, believes that U.S. exchanges face significant competition: “I am known for being blunt. So let me put this bluntly. Those who would tell you that U.S. futures exchanges are monopolies and face no competition are out of touch with reality. There is more competition today than ever before.” Commodity Futures Trading Commissions: Hearing Before the Subcomm. on Gen. Farm Commodities of the H. Comm. on Agric., 107th Cong. (2003) (statement of Charles P. Carey, Chairman of the Chicago Board of Trade).
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Traditionally, once a market achieved liquidity and dominance in a particular product, no challenger emerged. Traditionally, trading and clearing were inextricably linked; one function supported the other and shut out potential competitors that might want to offer similar services. In fact, traditionally, few markets even attempted to challenge dominant markets by offering a new contract design, method of trading or clearing efficiency.\(^2\)

Unlike established products, exchanges in the United States readily compete on new products. Nevertheless, new products rarely succeed.\(^2\) Despite large research and product development departments within exchanges, creating new, successful contracts is very challenging. Many new ideas for new product competition are thrown at the dartboard, and most fail.

An example of this dartboard development technique occurred in mid February of 2000 when the CME and the CBOT simultaneously launched competing “agency-note” futures linked to debt issued by Fannie Mae and Freddie Mac.\(^23\) Due in part to an aggressive incentive program, CME won the initial liquidity battle and its combined Note products traded almost 12,000 contracts on the Merc during their debut. However, the CME volume quickly fell thereafter and the CBOT took control of the fledgling contracts when it posted open interest of 12,800 contracts and volume of 13,300 two weeks after.\(^24\) Subsequently, trader and institutional interest in these contracts on both exchanges faded, and the contracts ended up in the massive graveyard of tried but unsuccessful futures products.\(^25\)

\(B.\text{ Enter Competition—The Commodity Futures Modernization Act Becomes Law}\)

With the explicit goal of “enhanc[ing] competition” in the markets for


\(^22\) An example of the successful nature of product development is the development of energy futures by the NYMEX in 1978. Exchanges: Growth and Change the Ongoing Story, FUTURES, Mar. 1992, at 52. At the time of the development of energy futures, it was unclear if the NYMEX would survive as it was “reeling” from potato futures default and manipulation problems in the late 1970s. Id.; see also Paul Meier, Derivatives—History and Outlook, FX&MM, Feb. 13, 2003, available at http://www.gtnews.com/article/4880.cfm.


\(^24\) Id.

\(^25\) There are many reasons why a new futures contract will not succeed. One of the most reasonable explanations is that there is not an end customer need for the product. In other words, while the “locals” trading in the pits (as speculators) at the exchanges in the United States can support a new contract by trading with each other for a period of time, eventually, in order to succeed, the contract must appeal to some end-user base that needs to use the contract for hedging purposes. The entry of end-users into the marketplace is sometimes referred to as getting “customer paper” into the trading mix (or, more bluntly, finding “food” for the market). Without the customer paper, the product cannot survive. Stated slightly differently, without hedgers, the speculators can only last so long and the contract will die.
futures and over-the-counter derivatives, Congress passed, and President Clinton signed into law, the Commodity Futures Modernization Act ("CFMA") in late 2000.26 As the CFMA provided a "lighter" and more flexible regulatory scheme for market participants, Congress hoped that new entrants would be encouraged to compete, and that U.S. exchanges could compete more effectively internationally.

One of the ways the CFMA set out to achieve marketplace competition was to promulgate "core principles," as opposed to traditional overly proscriptive rules, regulating exchanges and clearinghouses.27 For example, the CFMA provided a specific core principle addressing antitrust issues as they relate to exchanges:

**ANTITRUST CONSIDERATIONS—**Unless necessary or appropriate to achieve the purposes of this Act, [a] board of trade shall endeavor to avoid—

(A) adopting any rules or taking any actions that result in any unreasonable restraints of trade; or

(B) imposing any material anticompetitive burden in trading on the contract market.28

Despite a limited legislative history, many legislators, regulators and industry participants have hailed the CFMA as pro-competition legislation. For example, the Acting Chair of the Commodity Futures Trading Commission, Sharon Brown-Hruska, stated:

Prior to the CFMA, the market was regulated with a one-size-fits-all model. It did not matter whether a customer was commercially sophisticated; whether the underlying commodity was susceptible to manipulation; whether a customer needed the flexibility of an over-the-counter contract or the liquidity of an exchange-traded one; or whether there was more than one way to deliver customer protections in the marketplace. This recognition by Congress of these differences represented a significant step forward in its design of the regulatory oversight structure. When Congress adopted the CFMA, it put in place a practical, principles-based model and gave the CFTC the tools to regulate markets that were challenged by competition brought about by technology and an increasingly global marketplace.

... the innovation, competition, and customer choice envisioned by Congress in passing the CFMA is bearing fruit.29

Brown-Hruska’s testimony in support of the CFMA was not without warrant. From 2000 through 2004, the volume of futures and options contracts traded on U.S. exchanges increased from 600 million to over 1.6 billion per

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27. Id. § 2.


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year.\textsuperscript{30} The product range also increased dramatically from 266 to 556 regulated contracts. The CFTC approved eight new Designated Contract Markets (futures and options exchanges).\textsuperscript{31} And finally, eleven Exempt Commercial Markets\textsuperscript{32} and three Exempt Boards of Trade filed notifications with the Commission indicating that they were open for business.\textsuperscript{33}

The initial wave of competition after the passage of the CFMA swept the derivatives industry. There was unprecedented competition at all levels of the industry—among the regulated exchanges, in the over-the-counter versus the regulated exchanges, and even between clearinghouses. Some of the competition included:

-- Exchange Place Futures Exchange, LLC, also known as “Brokertec Futures Exchange,” a joint venture of several of the largest investment banks, was formed in 2001. It listed futures and options on futures electronically in the Treasury complex of contracts competing directly against CBOT.\textsuperscript{34}

-- Several online energy exchanges emerged to compete with the incumbent regulated futures exchange, the New York Mercantile Exchange (“NYMEX”), as well as with the over-the-counter “voice brokers.” These new Internet-based exchanges included: Intercontinental Exchange (“ICE”) (notice given to CFTC in 2001), Houston Street (notice given to CFTC in 2002), TradeSpark (notice given to CFTC in 2002), Natural Gas Exchange (notice given to CFTC in 2002), Optionable (notice given to CFTC in 2001), Spectron Live.com Limited (notice given to CFTC in 2003), as well as Altrade and Red Meteor;\textsuperscript{35}

-- A new clearinghouse, EnergyClear, a joint venture of the Bank of New York, as well as energy voice brokers Prebon Yamane and Amerex, was created in 2000 (and approved by the CFTC as a Derivatives Clearing Organization in 2001) to offer netting and settlement of

\textsuperscript{30} Id.
\textsuperscript{31} Id.
\textsuperscript{32} An “Exempt Commercial Market” is a marketplace that is exempt from most, but not all, provisions of the Commodity Exchange Act and CFTC regulations. In order to qualify as an Exempt Commercial Market, such market must not allow “retail” customers to trade on it. That is, the market is only usable by large, typically institutional, users. See generally Commodity Exchange Act, 7 U.S.C. § 2(h) (2006); Exempt Commercial Markets, 17 CFR § 36.3 (2006).
\textsuperscript{33} Brown-Hruska Testimony, supra note 29.
wholesale energy contracts for the over-the-counter marketplace in competition with the NYMEX and the London clearinghouses.  

-- The St. Louis Merchants Exchange, a regulated futures exchange, was formed in 2000 to offer the same energy contracts as NYMEX.  

-- U.S. Futures Exchange, LLC, also known as "Eurex US," was approved by the CFTC as a Designated Contract Market ("DCM") in 2004. Eurex US listed futures and options on futures in the Treasury complex of contracts competing directly against CBOT.  

-- Eurex US also listed foreign exchange ("FX") products in competition with the CME, as well as the New York Board of Trade on September 23, 2005.  

-- CBOE Futures Exchange, LLC ("CFE") was approved by the CFTC in 2003 as a DCM. CFE's primary product is volatility indexes, which compete to a large extent against the CME.  

-- Eurex US and CFE separately listed the Russell 1000 and Russell 2000 Index products in 2005 in direct competition with the CME and the New York Board of Trade.

The entry of these new competitors led to competition among the long-time, established exchanges. The legacy exchanges "took their gloves off" and, for the first time in history, began competing against each other in "franchise" products. For example:

-- The CBOT listed metal products (gold and silver) in direct competition with NYMEX's metal exchange subsidiary, the Comex, beginning on October 6, 2004.  

-- Euronext-Liffe, a foreign futures exchange authorized to do business in the United States under CFTC regulations, offered Eurodollar


38. *See Designated Contract Markets Registered with the CFTC*, http://www.cftc.gov/dera/deadcms_table.htm [last visited Nov. 13 2006] [hereinafter CFTC Designation Table].  


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contracts, the flagship product of the CME, in 2004 through its electronic trading system.\(^{43}\)

-- CBOT, based out of Frankfurt, Germany, listed German interest rate products in direct competition with Eurex AG in 2004.\(^{44}\)

-- NYMEX listed the Brent Crude Oil contract in direct competition with the International Petroleum Exchange ("IPE") in 2001 and then again in 2004.\(^{45}\)

-- The IPE indicated that it would list the West Texas Intermediate ("WTI"), the most important type of oil produced in the United States) oil contract in direct competition with NYMEX on February 2, 2006.\(^{46}\)

Similar to Euronext-Liffe, the IPE is a foreign futures exchange that operates in the United States pursuant to a no-action letter issued by the CFTC.\(^{47}\)

To the extent Congress sought to increase competitive activity by passing the CFMA, the Act was a huge success. However, has any of this competitive activity actually resulted in success by the competing exchange? Moreover, have consumers of the exchange products realized any long-term benefits as a result of the increased competitive activity? In other words, did the CFMA lead to "real" competition?

C. The Results of Competition Six Years After Passage of the CFM—With Few Exceptions, the Incumbents Are Winning in a Landslide

The current model in which exchanges have their own "captive," in-house clearing organizations, "is one of the strongest de facto monopolies on earth."

\ldots

We do not have a competitive environment right now. Instead, we have exchanges that are each monopolies in their own products. And customers don't thrive under monopolies.\(^{48}\)

While the competition statistics from the CFMA appear to paint a positive


\(^{44}\) E-cbot Bulletin #38 of 2004 (CBOT, Chi., Ill.), Apr. 14, 2004, http://www.cbot.com/cbot/pub/cont_detail/0,3206,1123+18742,00.html ("On April 23, 2004, the CBOT will launch Bund, Bobl, and Schatz futures on the e-cbot platform, with seven firms serving as market makers within the German debt complex.").


\(^{46}\) ICE Futures Launches Electronically Traded WTI Crude Futures Contract 1:00 AM in U.K., 8:00 P.M. ET., (Intercontinental Exchange, Atlanta, Ga.), Feb. 2, 2006, https://www.theice.com/showpr.jhtml?id=1240.


\(^{48}\) Clearing Firms and Exchanges at Odds at CFTC Clearing Roundtable, SEcurities Week, Aug. 5, 2002, at 1 (quoting remarks made by John Damgard, President, Futures Indus. Ass'n).
picture, the actual competition between exchanges has been much less impressive. Few of these newly listed exchanges have been able to break into the liquidity held by the legacy exchanges. Indeed, while the CFTC has touted the statistics concerning post-CFMA new exchanges seeking designation with the CFTC, such have been offset by the statistics highlighting exchanges either closing shop or ceasing trading. According to the CFTC materials, nine exchanges have shut their proverbial doors since passage of the CFMA (as compared to eight that were approved post-CFMA).

Moreover, challenges to the “core” products of the existing exchanges have not succeeded. For example, after failing to attain any meaningful market share in the treasury market against CBOT, Broker Tec Futures was purchased by Eurex US. Similarly, Eurex US was unable to break CBOT’s monopoly on the treasury products, and in June 2005, Eurex US announced that it had effectively given up the fight against CBOT. Eurex US claimed that a significant reason for its inability to gain traction in the product was CBOT’s alleged anticompetitive activity, which is now the subject of a pending antitrust lawsuit. This article discusses the antitrust lawsuit in greater detail infra, in Section IV.

Other results of the post-CFMA competition are:

-- EnergyClear ceased operations on July 9, 2004, Merchants Exchange ceased operations on September 30, 2004, and CFE has failed to gain any meaningful market share on any of its products, typically trading less than 5,000 contracts a day.

-- In early 2005 Eurex US maintained between four to eight percent of the market share in the Russell contract, but it has had to waive fees and pay “market makers” to do so.

49. CFTC Designation Table, supra note 38.
52. Id.
54. CFTC Designation Table, supra note 38.
56. U.S. Futures Exchange, http://www.eurexchange.com/about/press/press_393_en.html: Eurex US is waiving all trading fees for all market participants for the first three months of trading in the Russell products. Twenty-two firms are acting as market makers for the new products and are providing additional liquidity and increasing order book depth by continuously quoting prices and offering competitive spreads. Market makers will be active during the core U.S. trading hours (8:30 am to 3:00pm CST).
“Market makers” are speculators who continuously offer to both buy and sell the relevant contract. See
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-- CBOT’s foray into precious metals in competition with NYMEX/COMEX has shown the most promise of all the efforts to take on an established product. While CBOT’s market share was in the 1-2 percent range for quite some time, it seemed to hit a “tipping point” in late 2005 when its market share jumped to a steady 10 percent.57 More recently, CBOT’s market share in gold has risen to 44 percent.58

-- Euronext-Liffe failed to attract any significant liquidity to its Eurodollar contract, and acknowledged that it was going to give up the battle of the Eurodollar.59

-- CBOT has failed in its efforts to trade the core European fixed income products from Eurex. Indeed, the contracts failed after having no trading activity.60

-- Finally, despite incentive programs paying traders up to $200,000 a month, NYMEX has not attracted any significant volume in its efforts to take the Brent crude oil contract from IPE. With some limited exceptions, its volume is in the 3-5 percent range of total Brent contracts.61

The results of post-CFMA competition, or lack thereof, have not escaped industry observers. As noted in 2005 by Jeremy Grant, a long-time futures industry reporter for the Financial Times:

[T]o put it mildly, none of these initiatives has lived up to expectations. Eurex US’s share of the Treasury futures market is still under 5 per cent, with Euronext-Liffe scraping by on a Eurodollar share of roughly 2 per cent. The CBOT has barely made a dent on NYMEX. And the CBOT’s Bund, Bobl and Schatz initiative has sunk without trace.

....

The CBOT’s initiative stands out because it is an example of an electronically traded offering competing against an existing “open outcry” traded product. That

Harris, supra note 12, at 195.


After celebrating the one-year anniversary of launching its Precious Metals complex electronically, the CBOT marked another major milestone, with its Gold contracts (100 oz. and mini-sized futures) capturing a 15 percent market share of gold futures traded in North America based on volume for the month of December. Daily volume for the overall complex reached a record in December, surpassing 20,000 contracts in a single session.

58. David Roeder, CBOT Pan for Profits, CHI. SUN-TIMES, July 21, 2006, at 47.

59. John J. Lothian, Profits Soar for Euronext, JOHN J. LOTHIAN NEWSLETTER, Aug. 31, 2005, available at http://www.johnlothiannewsletter.com/archives.htm (“Euronext.liffe let it be known during their press conference ... that they will be scaling back their investment in Eurodollars. They will be winding down the contracts.”).


reinforces the view that it is where liquidity resides that counts, not the way products are traded . . . . The real barrier to stealing liquidity and thus successfully competing is the difficulty of shifting open interest from one clearinghouse to another.62

Indeed, the obstacle of moving (or, as incumbents often describe it, “stealing”) open interest to the challengers’ products was a central issue in the CME/LIFFE matter. This lawsuit is discussed in greater detail infra in Part D of this Section.

Furthermore, while many industry observers have noted the positive effects of competition on the marketplace, recent moves by the legacy exchanges suggest that such positive effects may be short-lived. For example, after sensing that the competitive threat from Eurex US was receding, and after the Eurex incentive program had expired, the CBOT and the CME raised their fees. The CME’s stock price rose 6 percent upon announcing its raise in fees, perhaps because it was able to demonstrate its pricing power in the market.63

D. Defeating the Incumbents Requires a “Perfect Storm”

As we have discussed, “liquidity is king” in commodity markets, and as a result, such markets are often insulated from competition. As put by one observer:

Stock exchanges are often revered as bastions of free markets, but the reality is that virtually all of them have been adept at squashing competition from anyone who would challenge their privileged position. Ever since the first stock exchange was founded in Amsterdam in 1611, these bodies have been owned by brokers who control the trading on the floor and make sure their interests are taken care of first.64

By the same token, liquidity has also been called a “black hole,” in that “the liquidity generated by the [new trading] system will start drawing in more and more buyers and sellers, not unlike a black hole.”65 So, the question is raised whether a market, once it obtains a critical mass of liquidity in a product (and thus becomes a monopoly in such product), can ever lose such liquidity. The most prominent, and perhaps only example of such an event was the so-called “Battle of the Bund.”

In the 1990s, Liffe had established the Bund contract as a crucial


64. Gregory Dalton, The Killer B-to-Bs, INDUS. STANDARD, Feb. 28, 2000; see also Six Southeast Wholesalers Join New Intercontinental Energy Exchange, PLATTS S.E. POWER REP., Aug. 4, 2000, at 4 (“‘Liquidity is King’ in determining whether . . . online exchanges will be successful . . . ”); Hoi Leung, Futures Exchange Takes a Hard Line on Various Issues, HONG KONG STANDARD, Dec. 28, 1998 (“In all of these markets, liquidity is king . . . . Once the liquidity is there, it will be a long term threat to [the dominant marketplace.”).

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cornerstone in its portfolio of products, and indeed, it was and continues to be one of the most heavily traded derivatives contracts in the world. Deutsche Terminboerse ("DTB"), the predecessor to Eurex, set its sights on the Bund contract for a number of reasons. Liffe was trading the contract via open outcry and because DTB was a fully electronic exchange, DTB thought that it had an opportunity to capture the contract due to the structural differences in the trading environment. In addition, the Bund is a German product, leading DTB to believe that it could appeal to German banks on a nationalist level to assist in their effort. Ultimately, the battle lasted seven years, after which DTB succeeded in taking the Bund contract from Liffe.

As described by industry commentator, Patrick Young, the "Battle of the Bund" tipping point occurred in 1997:

For years, Liffe had dominated the [Bund] market. By March 1997, the DTB had managed to capture only a very paltry share of 35 percent of Bund futures trading. In April, this creaked up to 37.5 percent but after six years of head-to-head contest, progress was hardly significant. Then as 1997 progressed, volume began to drift upwards on the DTB. It wasn't a passive situation, the Frankfurt management had made a no-holds-barred attempt to coax the business away from the London market. Turnover reached 43 percent in July 1997 when trading hours were extended by 90 minutes. The major catalyst, however was the Maastricht Agreement, which guaranteed free trade throughout the European Union. Amongst the treaty's many provisions, one permitted any European marketplace's terminals to be sited anywhere within the other European nations.

By September 1997, the gloves were off and the knuckle dusters on in the fight for market share in the Bund. Exchange or clearing fees were waived at both the DTB and Liffe.

By October, Liffe's share of the Bund business was down to 52 percent. However, the DTB's policy of disseminating their screens far and wide [ ] was beginning to pay off in terms of volume growth—and more significantly market share.

The full frontal assault on Liffe's Bund business went ballistic on January 1st, 1998. The DTB dropped up-front admission and annual membership fees for full members and market makers, and slashed those for clearing members. Telecommunication line fees were also dropped, replaced by a minimum transaction fee of DEM 4,500 per month.

On Wednesday October 22nd 1997, the turning point had been reached. The DTB surpassed Liffe's Bund market share with 52 percent of that day's volume. From then on, the Germans never looked back.

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67. Id.
The battle for the Bund required a "perfect storm" before the long sought after transfer of liquidity. Because Liffe was open outcry and DTB was electronic, DTB was able to take advantage of the dislocation created by the differences in trading systems. The Maastricht Agreement not only contributed to this dislocation but also created an opportunity for DTB to distribute its trading system both far and wide. The "last leg of the stool" was money, and DTB ultimately created the "perfect storm" allowing for the transfer of liquidity by not charging traders fees for trading its Bund contract.

More recently, notable post-CFMA dislocations created the potential of allowing for additional liquidity transfers. For example, when Eurex entered the US market to compete with CBOT in the market for Treasury derivatives, there were various factors indicating that Eurex had an opportunity to replicate DTB’s successful transfer of liquidity in the Bund market:

-- CBOT was in the process of changing its trading system from the Deutsche-Boerse created “ACE system” (ACE meaning “Alliance between Chicago Board of Trade and Eurex”) to the Liffe Connect product, thereby requiring its traders to undergo a complicated change in technology;

-- CBOT was in the process of changing its clearinghouse from The Board of Trade Clearing Corp (“BOTCC”) to the CME clearinghouse. This changeover required the cooperation and execution by a number of parties, including the CFTC.

-- Because Deutsche Boerse was the owner of the ACE system and also one of Eurex’s parent organizations, Eurex could easily utilize this technology once CBOT changed systems. This way, Eurex had a built-in trading system with distribution channels to key traders.

-- In an attempt to attract liquidity to its platform, Eurex invested significant funds into the treasury product, including $18 million in market making and other trading incentives.69

In the end, Eurex did not prevail in this battle and announced a retreat. Nevertheless, Eurex asserts that one of the reasons for its inability to win this market was illegal anticompetitive activity by CME and CBOT, and filed an antitrust lawsuit alleging these claims. This lawsuit is discussed in Section IV, infra.

The other notable market dislocations with the potential for post-CFMA liquidity transfers relate to NYMEX, mainly because it is one of the world’s few remaining bastions of open outcry trading. The Intercontinental Exchange (“ICE”), an all-electronic OTC energy-trading platform, has made inroads with NYMEX’s natural gas contract and also NYMEX’s West Texas Intermediate

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oil contract. As of October 2005, ICE had captured approximately 35 percent of the cleared market for Henry Hub natural gas,\textsuperscript{70} and 15-20 percent of the cleared market for WTI oil.\textsuperscript{71}

Another exchange currently challenging a NYMEX commodity is CBOT. As noted above, CBOT has listed precious metals contracts, namely gold and silver, on its electronic trading system in competition with the COMEX division of NYMEX. Like the DTB-Liffe battle, an open outcry model is being seriously challenged by an electronic model, and CBOT has made significant inroads into the gold product, obtaining 50 percent of the market as of June 2006.\textsuperscript{72}

Finally, in an ironic twist of the open outcry-electronic battles, NYMEX is attempting to take liquidity from the Brent Oil contract by attacking IPE from an open outcry model. IPE took the Brent Oil contract fully electronic in April 2005, and NYMEX saw an opportunity to tap into the disgruntled open outcry traders facing unemployment. NYMEX opened an open outcry exchange with extremely generous incentive programs in Ireland attempting to attract these traders. However, thus far, the Brent battle has not borne fruit for NYMEX.

In summary, the CFMA and technological advancements have led to exchange level competition in the futures and options marketplace; however, there have not been any significant success stories. One crucial reason for this failure is that existing liquidity creates a very high barrier to entry, and consequently, the alleged creation of further barriers to entry will be central to antitrust concerns in this area.

IV. BASIC ECONOMIC AND ANTITRUST PRINCIPLES

A. The Economic Goals of Antitrust

Exchanges may now be open to competition, but exchange competition appears to be competition “for the market,” as opposed to the competition, for example, between local gasoline stations. Antitrust policy should seek to allow competition to occur, allowing for the most efficient firm to succeed in the market, and for the benefits of that efficiency to be passed on to consumers.

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\textsuperscript{70} In its S-1 Registration Statement filed with the SEC in October 2005, ICE reports that it has average daily volume in its Henry Hub over-the-counter cleared natural gas contract of 29,000 contracts. NYMEX has average daily volume in its Henry Hub over-the-counter cleared natural gas contract of 8,000 contracts and 75,000 average daily volume in its cleared Henry Hub futures contract. Thus, adding NYMEX’s cleared contracts (its OTC and futures contracts) compared to ICE’s OTC contract, implies that ICE’s overall percentage is approximately 35 percent.


The recognized goals of antitrust vary slightly, but we will start with the premise that the goal of antitrust is to maximize the net economic wealth for society by facilitating the provision of goods with higher quality and lower costs. In other words, we assume the goal of antitrust is explicitly not to protect incumbent firms and their presumed supra-competitive prices.

B. The Rule of Reason and the Basic Elements of an Antitrust Case

The antitrust cases we will discuss here are “rule of reason” cases. The rule of reason dates back to the Supreme Court decision in *Standard Oil v. United States*, and requires a logically consistent economic theory of anti-competitive harm, along with evidence supporting that theory.

Also, like all antitrust cases, the cases we will discuss here contain two essential elements: 1) a concentrated antitrust market; and 2) barriers to entry into that market.

1. Antitrust Market Defined

A monopolization attempt refers to the actions of a firm that is “dominant” in an “antitrust market.” Measures of “dominance” can vary, but according to *United States v. Aluminum Co. of America (ALCOA)*, a 66 percent market share is generally considered sufficient to show dominance.

However, defining an antitrust market, especially in a monopolization case, can be a far more daunting task. The reason for this is that there are always substitutes for an economic product. For example, one can gain the same financial exposure from a share of stock by being long in a call with an exercise price equal to the stock price, and short in a put with the same exercise price. Nevertheless, this does not mean call/put packages are in the same antitrust market as the stock. The transaction costs from acquiring the call/put or trade combination may be significantly greater than those associated with simply acquiring the stock.

An antitrust market has two dimensions: product and geographic (though we focus on the product market dimension). The United States Department of Justice/Federal Trade Commission 1992 Horizontal Merger Guidelines define the product market as:

[T]he Agency will delineate the product market to be a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products (“monopolist”) likely would impose at least a “small but

73. RICHARD POSNER, ANTITRUST LAW 2 (Univ. of Chi. Press 2001) (1976) ("[T]he only goal of antitrust law should be to promote efficiency in the economic sense ... ").
74. 221 U.S. 1 (1911).
75. Id.
76. 148 F.2d 416 (2d Cir. 1945).
77. See, e.g., Hull, supra note 6, at 174-75.
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significant and nontransitory" increase in price. That is, assuming that buyers likely would respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If the alternatives were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise prices would result in a reduction of sales large enough that the price increase would not prove profitable, and the tentatively identified product group would prove to be too narrow.\footnote{1992 Horizontal Merger Guidelines (with April 8, 1997 Revisions to Section 4 on Efficiencies), available at http://www.ftc.gov/bc/docs/horizmer.htm. The geographic approach is similar.}

In simpler terms, a group of firms is considered to be an antitrust market if they can raise their price a small but significant amount (perhaps 5 percent) without losing a considerable number of customers. With respect to commodities exchanges and the Eurodollar contract, we must ask ourselves, if all exchanges trading Eurodollars jointly raised their fees by 5 percent, would a significant number of customers switch to other instruments?

The difficulty with the Merger Guidelines test is that it applies to mergers, not monopolization cases. Using this market definition in a monopolization case risks falling into the famous "Cellophane trap."\footnote{Named after the product at issue in the famous antitrust case, United States v. E. I. du Pont de Nemours & Co., 351 U.S. 377, 391 (1956).} Assume, for example, that apples and oranges are in separate antitrust markets, but each constitutes the others' "nearest" competitor. If a firm is able to monopolize the apples market and raises the price of apples, this would result in customers switching to the apples' nearest competitor, the oranges. By failing to detect the possibility of monopolization, the Merger Guidelines test would wrongfully conclude that apples and oranges were in the same antitrust market.

While there are no definitive methods of avoiding the Cellophane trap within commodity exchanges, we can consider those competitive threats that the relevant exchange contract has faced in the past. If those threats have consisted solely of other entities threatening to establish contracts in the same product, the situation would be a sufficient, but certainly not necessary, for establishing the product as an antitrust market. On the other hand, if this condition is not met, defining the relevant antitrust market may be problematic.\footnote{More precisely, from the court decision: The Commission defines the relevant product market as 'the sale of consumable office supplies through office superstores,' with 'consumable' meaning products that consumers buy recurrently, i.e., items which 'get used up' or discarded. For example, under the Commission's definition, 'consumable office supplies' would not include capital goods such as computers, 970 F. Supp. 1066, 1070 (D.D.C. 1997).}

Another approach to defining antitrust markets was presented in FTC v. Staples, Inc.\footnote{See discussion of CME/LIFFE, infra Part VI.A.3.} In this matter, the FTC sued to prevent Staples from buying its rival, Office Max. The relevant product market asserted by the FTC was, in short, "office superstores."\footnote{970 F. Supp. 1066, 1070 (D.D.C. 1997).} And although this definition was counter-intuitive
in that consumers can and do buy office supplies through a number of other distribution channels, the case did not ultimately turn on the overly broad definition. Instead, the crucial evidence for the FTC was data indicating Staples’ and Office Max’s prices were between 5 to 13 percent higher than those found in markets where one firm did not compete against the other. In effect, this evidence subsumed the Merger Guidelines test. Because prices were higher where the two firms did not compete, eliminating the competition between the two firms via merger would increase prices to consumers.

If exchange antitrust markets can be defined on a product-by-product basis (which may often be appropriate), then they are likely to have one incumbent and one entrant, and are therefore likely to be considered concentrated.

2. Barriers to Entry

Simply having a monopoly in an antitrust market is not sufficient to exercise market power. In order to exercise market power, a firm must be protected by a barrier to entry – something stopping entry from occurring once the monopoly firm charges supra-competitive prices.

Over the last 35 years, authors have proposed a number of definitions for barrier to entry, but unfortunately, these definitions have not been entirely consistent. A recent article by McAfee, Mialon and Williams focuses these definitions in a tractable fashion that can be used in antitrust analysis. They categorize barriers to entry into economic and antitrust barriers, where the first barrier is a subset of the second.

McAfee et al. begin by separately defining an economic barrier to entry and an antitrust barrier to entry. An economic barrier to entry is, “a cost that must be incurred by a new entrant that incumbents do not or have not had to incur.” An antitrust barrier to entry is “a cost that delays entry, and therefore reduces social welfare relative to immediate but costly entry.” For example, the CME has been trading commodities since the late 1800’s. If a new regulation requires any new competitor to gain regulatory approval from the federal government, and the approval process is an onerous and uncertain one, then this scenario would constitute both an economic barrier to entry and an antitrust barrier to entry.

fax machines, and other business machines, or office furniture, but does include such products as paper, pens, file folders, post-it notes, computer disks, and toner cartridges.

Id. at 1073.

83. See, e.g., J.S. Bain, Barriers to New Competition (1956); James Ferguson, Advertising and Competition (1974); Daniel Carlton & Jeffrey Perloff, Modern Industrial Organization (1994).

84. R. Preston McAfee et al., What is a Barrier to Entry?, 94 Am. Econ. Rev. 461, 461-65 (2004).

85. Id.

86. The Merc, supra note 7.
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The process of operationalizing the definition of an antitrust barrier to entry is a bit involved, but the essential elements are a combination of sunk costs, economies of scale, and uncertainty. Sunk costs refer to costs that, once borne by the entrant, cannot be recouped by the entrant should it decide to exit the market. For example, if a firm decides to enter the automotive industry, it will have to build a manufacturing plant, and if the firm then decides to exit the automobile business, it owns a plant that may not be very valuable in other economic uses. The firm has therefore "sunk" costs into its facility as a condition of entry.

Economies of scale are also important in antitrust barriers to entry. Where a firm can enter a market on a very small scale, its sunk costs are likely to be small, and likewise, any potential losses resulting from exiting the market are likely to be small. Thus, if a firm can compete effectively by selling one percent of the product in a particular market, antitrust barriers are likely to be low. If, on the other hand, to be successful a firm has to compete for the entire market, it raises the possibility of significant entry barriers.

The final ingredient in antitrust barriers to entry is uncertainty. If there is no uncertainty in success, then there is no risk from sinking costs, and therefore no barrier to entry. Ex ante, however, it is often not clear whether or not a potential entrant will be successful.

Recent economic literature has cited the barrier to entry properties of network industries. A network industry can be described as having a product that becomes more valuable with every additional person using it. The telephone is a classic network product. A telephone owned by one person is useless by itself, and only if another person owns a "linked" telephone, is the first telephone useful. If a third person obtains a telephone and gets linked to the network, the first two telephones now become more valuable, as they can be used to reach that third person. This process continues as more people buy telephones, and where one telephone system gets large, it becomes more valuable at the same time its rivals' systems become less valuable. The result is that local telephone networks, absent switching (a very modern event), are natural monopolies.

Network economics played a starring role in the prominent Microsoft case. According to the theory of the case, as Microsoft's operating Windows

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89. This externality effect serves as the rationale for subsidizing universal service, which attempts to get as many people as possible in society hooked up to the telephone network.
90. See, e.g., John E. Lopatka & William H. Page, Antitrust on the Internet: Microsoft and the Law
system became more and more dominant, more and more software developers created their products to be compatible with Windows. This made it harder and harder for other operating systems to get into the market.

Futures and commodity exchange platforms fall within the definition of a network industry. The more trades and traders on a particular exchange, the more quickly trades can be executed, the better the price, and the more able the exchange is to better serve the needs of its customers. Consistent with the discussion in Section II, this implies that competition in any commodity exchange market is "competition for the market."\textsuperscript{91} In a "winner take all" construct, firms are, in effect, competing for the right to be monopolistic and consumers are best served by having the most efficient firm win.

The market for a network good is, by definition, difficult to enter. Upon entry, the entrant's product is inherently inferior to that of the established firm. Thus, the basic method for the entrant to gain customers is to "buy" or "rent" them, either by directly paying them to switch products or by offering their product for a substantially lower price.\textsuperscript{92} As the discussion in Section II indicates, new entrants in this industry have had very little success overcoming the relevant barriers to entry. Commodity markets are notoriously "tippy," with competition often being for the market rather than within the market, and consequently, the importance of economies of scale and of any artificial incumbent created barriers to entry is increased.

C. Antitrust and Economics: Summary

Under the rule of reason, a successful antitrust case must satisfy a number of requirements. The antitrust plaintiff must have a theory of how consumers have been or are likely to be injured. The antitrust plaintiff must identify a well-defined market that is allegedly being monopolized. That well-defined market must have a barrier to entry, otherwise even a monopolist could not charge supra-competitive prices. And finally, for a commodity exchange antitrust case to be successful, it needs to find a court willing to listen to it. For the antitrust plaintiff, this may be the most significant obstacle of all, and we turn to this difficult question next.

V. ANTITRUST JURISDICTION AND IMMUNITY IN REGULATED INDUSTRIES—
CAN PARTIES GET TO COURT?

In all regulated industries, the regulator takes responsibility for at least

\textsuperscript{91} See Demsetz, supra note 16, at 55-65.

\textsuperscript{92} One of several articles discussing "buying customers" in an antitrust context is Andrew N. Kleit & Malcolm B. Coate, Are Judges Leading Economic Theory?: Sunk Costs, the Threat of Entry, and the Competitive Process, 60 S. ECON. J. 103 (1993).
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some of the industry’s competitive practices, and this provides for a potential conflict of interest between the regulator’s actions and the court-determined antitrust laws. Thus, for a plaintiff in a regulated industry to get to court, it must first show that the court has jurisdiction. Unfortunately, there is a good deal of tension in the law on this issue.

The critical issue here relates to the doctrines of implied repeal of, or implied immunity from, the antitrust laws and Primary Jurisdiction. These doctrines basically determine whether a plaintiff can go to court with an antitrust claim in the context of a “regulated industry,” whether the plaintiff must pursue the matter before the federal agency overseeing the regulated industry, or whether the issue is immune from antitrust laws altogether.

In this section we will first review the major jurisdiction on this issue. We will then comment on what we believe the appropriate law should be. As we will describe, this is a line of cases that started well, but is in danger of “falling off the tracks.” We will then review the recent history of CFTC antitrust jurisdiction.

A. A Brief History of the World of Implied Immunity and Primary Jurisdiction

1. Silver

The seminal case in this area is *Silver v. New York Stock Exchange*. While *Silver* involved an antitrust challenge in the context of the securities industry, its ruling has been equally relied upon in the commodities area. In *Silver*, Harold Silver operated Municipal Securities, Inc., a securities firm for trading corporate over-the-counter securities. Because communication with the marketplace and obtaining market data are of great importance in trading activities, Silver, who was not a member of the New York Stock Exchange (“NYSE”), arranged to have direct private telephone wire connections with members of the NYSE. While the NYSE originally approved of the connections, it later rescinded its decision and cut-off Silver’s connection to the important securities trading data. Silver brought the action alleging, *inter alia*, violations of Sections 1 and 2 of the Sherman Act. The case went to the Supreme Court on the issue of “whether the Securities Exchange Act has created a duty of exchange self-regulation so pervasive as to constitute an

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96. *See, e.g., Ricci*, 409 U.S. at 303 (discussing *Silver*, 373 U.S. 341 (1963)).

97. *Silver*, 373 U.S. at 343-44.

98. *Id.*
implied repealer of our antitrust laws, thereby exempting the Exchange from liability in this and similar cases.\textsuperscript{99}

Although the \textit{Silver} Court began its analysis by noting the difficulty in reconciling conflicts between the pursuit of eliminating antitrust restraints and the NYSE’s “general power to adopt rules governing its members’ relations with nonmembers,”\textsuperscript{100} it ultimately held that the NYSE was not exempted from the antitrust laws.\textsuperscript{101} The Court made clear that:

The Securities Exchange Act contains no express exemption from the antitrust laws or, for that matter, from any other statute. This means that any repealer of the antitrust laws must be discerned as a matter of implication, and “it is a cardinal principle of construction that repeals by implication are not favored.” [citations omitted]. Repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary.\textsuperscript{102}

As noted in the academic literature, \textit{Silver} articulated a basic two-part test for implied repeal:

Immunity may be predicated upon either (1) a finding that the administration of the regulatory statute is incompatible with the maintenance of private antitrust suites (statutory incompatibility); or (2) the defense that the activity’s competitive impact, in the absence of direct agency oversight, is the minimum necessary to fulfill self-regulatory duties under the regulatory statute (“rule of reason”).\textsuperscript{103}

Although there was a comprehensive regulatory framework in place, there was no direct securities regulation addressing the telephone issue found in \textit{Silver}. Accordingly, the Court denied the defense of Implied Immunity.\textsuperscript{104}

\textbf{2. Ricci}

The next significant decision in the “get to court” area involved the Chicago Mercantile Exchange (“CME”) in \textit{Ricci v. Chicago Mercantile Exchange}.\textsuperscript{105} Ricci was excluded from trading on the CME for almost a month, after which he purchased another membership at a much higher price than that of his previous membership.\textsuperscript{106} In \textit{Ricci}, he alleged that the CME transferred his membership in the exchange to another entity without notice or a hearing. And while the Implied Immunity doctrine from \textit{Silver} was reviewed, the Court’s decision ultimately turned on the issue of Primary Jurisdiction. That is, given the apparent tension between the dictates of the Commodity Exchange Act

\textsuperscript{99} \textit{Id.} at 347.

\textsuperscript{100} \textit{Id.} at 349.

\textsuperscript{101} \textit{Id.} at 357.

\textsuperscript{102} \textit{Id.}

\textsuperscript{103} \textit{After Gordon, supra} note 93, at 117.

\textsuperscript{104} \textit{Silver}, 373 U.S. at 357.

\textsuperscript{105} \textit{See Ricci}, 409 U.S. at 289.

\textsuperscript{106} \textit{Id.} at 290-91.
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(“CEA”), the Court examined whether the dispute should be sent to the Commodity Exchange Administrator, the regulating body overseeing whether claims should proceed to court or be decided at the agency level.

The Ricci Court first undertook a thorough analysis of the Commodity Exchange Act and the accompanying regulations promulgated thereunder before summarizing the problem in the case as:

...[A]rising when [] the reach of the antitrust laws is also at least arguably protected or prohibited by another regulatory statute enacted by Congress. Often, but not always, the other regime includes an administrative agency with authority to enforce the major provisions of the statute in accordance with that statute’s distinctive standards, which may or may not include concern for competitive considerations.

At the time of Ricci, the CEA did not contain any directive requiring the Commodity Exchange Commission to review or consider the impact of the antitrust laws in undertaking its activities. Nonetheless, the Ricci Court distinguished Silver, held that the doctrine of Primary Jurisdiction applied to the matter, and the dispute was stayed and sent to the Commodity Exchange Commission for resolution. This decision rested on three important premises:

(1) that it will be essential for the antitrust court to determine whether the Commodity Exchange Act or any of its provision are “incompatible with the maintenance of an antitrust action; (2) that some facets of the dispute between Ricci and the Exchange are within the statutory jurisdiction of the Commodity Exchange Commission; and (3) that adjudication of that dispute by the Commission promises to be of material aid in resolving the immunity question.

3. Gordon

The next step in the progression of the “get to court” cases was Gordon v. New York Stock Exchange. In Gordon, the plaintiff alleged that a variety of NYSE practices, and in particular fixed commission rates, violated the Sherman Act. The Supreme Court, however, held that the dispute was within the jurisdiction of the Commodity Exchange Commission and that Primary Jurisdiction applied. The Court stated that "Congress, in enacting the Commodity Exchange Act, had not intended to confer general antitrust immunity on the Exchange and its members with respect to that area of conduct within the adjudicative or rule-making authority of the Commission."

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108. Ricci, 409 U.S. at 290; see also United States v. W. Pac. R.R., 352 U.S. 59, 64 (1956): Primary jurisdiction... applies where a claim is originally cognizable in the courts, and comes into play whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special competence of an administrative body; in such a case the judicial process is suspended pending referral of such issues to the administrative body for its views.
110. After Gordon, supra note 93, at 119-22 ("[U]nder the Commodity Exchange Act at [the] time, '[t]he [CEA]'s area of administrative authority does not appear to be particularly focused on competitive considerations; there is no express provision in the Act directing administrative officials to consider the policies of the antitrust laws in carrying out their duties ....") (citing Ricci, 409 U.S. at 302 n.13).
111. Ricci, 409 U.S. at 302-06.
112. Id. at 302. Notably, the Court stated that it did not “find that Congress intended the Act to confer general antitrust immunity on the Exchange and its members with respect to that area of conduct within the adjudicative or rule-making authority of the Commission ....”
Act. In reviewing the issue, the Court made clear that determining antitrust immunity and/or implied repeal involved “a thorough investigation of the practice in the light of statutory restrictions and decided cases.” Upon conducting this review, the Court concluded “the commission rate practices of the exchanges have been subjected to the scrutiny and approval of the SEC. If antitrust courts were to impose different standards or requirements, the exchanges might find themselves unable to proceed without violation of the mandate of the courts or of the SEC.” And accordingly, the Court dismissed the matter based on the implied repeal/antitrust immunity doctrine.

4. Strobl

The next significant implied repeal case involving an antitrust matter and the Commodity Exchange Act was Strobl v. New York Mercantile Exchange, decided by the Second Circuit in 1985. Strobl is important from an implied repeal perspective because the underlying factual claims involved price manipulation, a specifically prohibited offense under the CEA. The defendants in Strobl argued that, based on Silver and Gordon, the antitrust laws no longer applied to activity in violation of the CEA. Not surprisingly, the Second Circuit was not persuaded and found that the case law held otherwise:

Defendants claim that Silver and Gordon can be read to say that when a commodities exchange activity is subject to the jurisdiction of some regulatory body, it is exempt from the antitrust laws. This over-simplified reading does not survive closer analysis. Both Silver and Gordon discussed potential conflicts between the antitrust laws and a regulatory scheme. [citations omitted]. Their holdings teach that antitrust laws may not apply when such laws would prohibit an action that a regulatory scheme might allow.

The Strobl Court then articulated the Gordon "plain repugnancy" standard (i.e., that only where there is a plain repugnancy between the antitrust laws and
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the underlying regulatory scheme will implied repeal be found),\(^{121}\) and noted that a simple “overlap” between the antitrust laws and the regulatory scheme is not sufficient for implied repeal.\(^{122}\) After a detailed analysis of the CEA price manipulation provisions and the legislative history of the 1974 amendments to the CEA, the *Strobl* Court held that “Congress desired the continued application of the antitrust laws to those anti-competitive practices that also violate the Commodity Exchange Act. There is no doubt that such laws have traditionally been applied to the commodities industry.”\(^{123}\)

5. Stock Options

Nearly twenty years later, the Second Circuit in *In re Stock Exchanges Options Trading Antitrust Litigation* was again faced with an implied repeal matter, this time in the securities rather than commodities law arena.\(^{124}\) The Second Circuit in *Stock Options* neither overruled nor negatively commented on *Strobl,*\(^{125}\) but appeared to reverse its course when finding implied repeal of the antitrust laws in a securities law matter.

The Court held that implied repeal was necessary “to preserve the authority of the [Securities Exchange Commission (“SEC”)] to regulate th[e] conduct [at issue].”\(^{126}\) The “conduct at issue” involved the trading of equity options on multiple exchanges. The *Stock Options* Court demonstrated that the SEC had thoroughly considered this question under its governing statutes, and over a period of thirty years, had taken contradictory positions accordingly.\(^{127}\) The Court identified the implied immunity test as only “operating in two narrowly-defined situations:”

First, when an agency, acting pursuant to a specific Congressional directive, actively regulates the particular conduct challenged, . . . and second, when the regulatory scheme is so pervasive that Congress must be assumed to have forsworn the paradigm of competition.\(^{128}\)

In addition, the Court noted that a conflict between the antitrust laws and

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\(^{121}\) *Id.*

\(^{122}\) *Id.*


\(^{125}\) *Id.* at 148 (“To be sure, antitrust immunity is not to be presumed from the mere existence of overlapping authority; rather the analysis must focus on the ‘potential’ for ‘conflicts between the antitrust laws and an authorized regulatory scheme.’”).

\(^{126}\) *Id.*

\(^{127}\) *Id.* at 139-42.

\(^{128}\) *Id.* at 147.
the regulation of equity options trading did not exist; nonetheless:

The appropriateness of an implied repeal does not turn on whether the antitrust laws conflict with the current view of the regulatory agency; rather it turns on whether the antitrust laws conflict with an overall regulatory scheme that empowers the agency to allow conduct that the antitrust laws would prohibit.¹²⁹

Despite the Strobl Court’s clear focus on “conflicts” between the antitrust laws and the regulatory scheme, the Stock Options Court “saw no way to reconcile [] SEC authority . . . with the antitrust laws.”¹³⁰ We note, however, that the Court reached its decision despite an amicus brief from both the SEC and the Department of Justice urging that it not grant immunity.

6. Trinko

More recently in 2004, the Supreme Court discussed implied repeal in Verizon Communications v. Law Offices of Curtis Trinko.¹³¹ This case is notable in that the Court addresses important issues in the commodities area, including refusals to deal in regulated industries, the “Essential Facilities” Doctrine, and monopoly leveraging. These topics are discussed in greater detail in Section VI, infra.

Trinko involves the 1996 Telecommunications Act and an antitrust challenge by a Verizon Communications competitor’s customer. Verizon was the local exchange carrier (“LEC”) for telecommunications in New York State, and the 1996 Telecommunications Act sought to “uproo[t]” the incumbent LEC’s monopoly and introduce new competition in its place.¹³² Pursuant to the 1996 Act and a consent decree entered into with the Federal Communications Commission, Verizon had an obligation to act fairly and competitively. Trinko alleged that, Verizon was unfairly filling rivals’ service orders on a discriminatory basis, “as part of an anticompetitive scheme to discourage customers from becoming or remaining customers of competitive LECs, thus impeding the competitive LECs’ ability to enter and compete in the market for local telephone service.”¹³³

Although dicta, as to implied immunity, the Trinko Court noted that:

[A] detailed regulatory scheme such as that created by the 1996 Act ordinarily raises the question whether the regulated entities are not shielded from antitrust scrutiny altogether by the doctrine of implied immunity. In some respects the enforcement scheme set up by the 1996 Act is a good candidate for implication of

¹²⁹. Id. at 149.
¹³⁰. Id. at 150.
¹³². Id., 540 U.S. at 402.
¹³³. Id. at 404.
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antitrust immunity, to avoid the real possibility of judgments conflicting with the agency’s regulatory scheme “that might be voiced by courts exercising jurisdiction under the antitrust laws.” 134

That said, it can be argued that Trinko reinforces the Strobl antitrust laws and regulatory scheme “conflict” standard of reviewing, as opposed to the general “pervasive regulatory scheme” analysis put forward by Stock Options.

B. Making Sense of the “Get to Court” Cases

To say that the implied repeal and Primary Jurisdiction cases lack adequate guidelines and/or a satisfactory standard to follow in future cases is an understatement. Nonetheless, the cases do illuminate a few boundaries surrounding application of the doctrine.

We believe that administrative agencies should have the ability to inoculate firms from antitrust immunity. Presumably, the whole point of an administrative agency is that it has specialized authority over a segment of the economy where open markets are subject to some types of failure. Thus, it is not surprising that an agency may wish to trump the antitrust laws, and courts should consider allowing this out of respect for the agency’s mission.

This does not mean that it is should be easy to gain antitrust immunity. Consumers’ rights to the benefits of competition are important and should be protected. If agencies do not directly assert antitrust immunity, or have policies that directly contradict antitrust principles, then it should not be granted. To this end, we believe there is much wisdom in the “plain repugnancy” standard articulated by the Court in Gordon.

The early cases, including Silver and Ricci, have generally held true to these principles. It is only when we get to Stock Options, where the defendants were granted antitrust immunity despite a plea in opposition from the relevant regulating authority, that problems arise. Further, the grounds for the plea’s denial was not that the activity was directly regulated by the SEC, but rather that it could be directly regulated by the SEC. Thus, such a ruling does not even allow a regulatory agency to deny authority.

Although not as troublesome as Stock Options, the Trinko decision also generates some qualms. Trinko dealt with a competitive matter directly regulated by the broad and seemingly all-encompassing FCC. The FCC typically has a clear administrative process to deal with most complaints.

Now compare the FCC to the CFTC. Unlike the FCC, the CFTC does not have a broad regulatory regime. Historically, much of its authority has been delegated to self-regulatory organizations, such as the CME and CBOT. Though antitrust was added in the 2000 CMFA as a core principle, the CME/LIFFE matter was the first case the CFTC has been asked to opine upon.

134. Id. at 406 (citations omitted) (emphasis added).
Other questions remain. If a complaint is sent to the CFTC, does the CFTC have to respond? If it does not, is the complainant precluded from going to court? Further, what remedies does the CFTC have? As of the beginning of 2005, the CFTC still had cases that involving events occurring in 1994 before it. Should the CFTC have the ability to grant injunctive relief? Should the CFTC be able to assess treble antitrust damages?

We believe that the CFTC should have the right to assert antitrust immunity for certain matters, and if the CFTC does not assert that right, then that should not preclude parties from having their day in court.

VI. TYPES OF ANTITRUST CASES

Rule of reason cases can fall into several categories. Of particular importance to commodity exchanges are vertical restraint, predation, and essential facilities cases.

A. Vertical Restraint Cases

1. Theory

Vertical restraints are those that a producing firm places on its customers. For example, refiners often constrain their affiliated gasoline stations not to sell other brands of gasoline, and automobile manufacturers often require their dealers to have extensive showrooms. Non-price vertical restraints are subject to the rule of reason, requiring an anticompetitive theory and evidentiary support for that theory. Here we will examine this requirement as a restraint with the potential for creating a significant barrier to entry.

An anticompetitive theory in the rule of reason context must meet three necessary conditions. First, there must be significant economies of scale in the relevant industry. This condition seems to be met with respect to commodity exchanges, as a trading platform must have a substantial share of the relevant market in order to be viable in a particular contract. Indeed, we have discussed how competition between exchanges is “for the market,” with the winner of the competition gaining a monopoly over all of the relevant business.


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Second, the number of firms potentially precluded by the restraint in question must be of such size to deter the potential entrant from growing large enough to achieve financial viability. If the competition is truly for the entire commodity exchange market, then excluding any sizable block of customers might be enough to "tip" the market back toward the incumbent.

Third, the restraint itself must be of "competitive significance." That is, it must pose a large enough economic deterrent to stop the affected firms from switching away from the incumbent. If the restraint in question "ties up" one percent of a market, it is not likely to be of competitive significance, whereas if it ties up 50 percent, it probably is.

Last, it is also possible that such a restraint has pro-competitive effects on economic efficiency. The standard example of such a pro-competitive effect is to deter free riding or "shirking" on an unpriced resource.137 An issue that may be of importance in commodity exchange competition is one exchange "free-riding" off the settlement or closing price of another.138

2. Application I: USFE v. CBOT/CME

In November of 2003, U.S. Futures Exchange (USFE, a subsidiary of the German exchange company EUREX) filed suit in Federal Court against the Chicago Board of Trade ("CBOT") and the Chicago Mercantile Exchange ("CME"). The suit essentially asserted that CBOT attempted to preclude a U.S. futures entrant exchange from having access to clearinghouse and regulatory services.

On January 10, 2003, Eurex announced that USFE would launch a U.S. exchange to compete with CBOT and CME in financial and stock futures and derivatives. In April of 2003, CBOT announced it was ending its 78-year relationship with TCC, a clearinghouse owned in part by CBOT members. On May 20, 2003, Eurex entered into an agreement with TCC to purchase all of TCC's stock for the purposes of using TCC as a clearinghouse for the incoming USFE exchange. On May 19 (one day prior to the Eurex and TCC agreement), CBOT offered to purchase TCC for "approximately $150-200 million, for allegedly the single purpose of shutting down TCC."139 CBOT's offer was rejected by TCC, and TCC stockholders voted to approve the acquisition by Eurex after Eurex agreed to pay TCC stockholders additional monies.

Taking the allegations by USFE to be true, we can see the clear outline of a rule of reason antitrust case. Commodity exchanges are potentially a

concentrated market, and considering network effects, they would appear to have important barriers to entry. Because clearinghouses are necessary to compete in the commodity exchange market, if CBOT can deny USFE access to the vertically related clearinghouse market, then they would be able to maintain market power over services provided at a commodity exchange.

This theory, however, poses several factual challenges. First, USFE will be required to show that commodity exchanges are a relevant antitrust market. In particular, as the result of bilateral negotiations between parties, a variety of financial contracts are traded "over the counter." In advancing its market definition argument, USFE asserted that, "[a] registered exchange differs from other trading environments, such as over-the-counter trades, because the regulatory environment allows for anonymity, greater liquidity, a distinct customer base, important trading and position benefits, and distinct tax advantages."¹⁴⁰

Second, USFE needs to show that acquiring TCC significantly reduced the cost and/or time of acquiring clearinghouse services. Certainly, USFE could have created its own clearinghouse service, or perhaps used the EUREX clearinghouse in Germany for this regard. Nevertheless, these alternatives may well have been more costly, and based on the experiences from previous exchanges, likely unsuccessful.¹⁴¹

Finally, should USFE succeed in showing antitrust liability on the part of the defendants, they would still need to show damages. Here, the damages would be the extra funds needed to acquire TCC, above and beyond what they would have paid had CBOT not interfered in the process.

CBOT, similarly, has its own potential burden of proof. It is likely that there is no efficiency justification for purchasing a TCC with the sole purpose of shutting it down. This type of output-contracting arrangement, as with price fixing and territorial allocation, is arguably per se illegal under the antitrust laws.

The reason for per se cases is now well known.¹⁴² If a particular practice is 1) likely to cause harm, 2) unlikely to generate benefit, and 3) showing the economic effects of that harm may be difficult to show, then a per se rule represents an efficient legal standard. Shutting down a clearinghouse to stop it from being acquired by a potential rival may well meet this standard.

First, shutting down an economic unit that would otherwise operate is likely to reduce economic output, and thereby harm consumers. Second, it is very difficult to establish an economic efficiency argument from this behavior. And

¹⁴⁰. Id.
¹⁴¹. For example, the BrokerTec Exchange, discussed infra, established its own clearinghouse at much expense and lack of success.
¹⁴². Much of this discussion comes from POSNER, supra note 73, at 39-40.
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third, just as the Cellophane trap problem makes it difficult to establish a market definition in these contexts, empirical economic effects may be difficult to show. For these reasons, CBOT may have difficulty defending its actions from a legal attack based on a per se theory.

The Court has denied both CBOT and CME's motions to dismiss the lawsuit. At present, the case between is now in its discovery phase. If the case is not soon resolved by way of settlement or summary judgment, it will likely go to trial in 2007.

3. Application II: CME/LIFFE

a. The Restraint in Question

CME operates a trading platform for Eurodollar futures contracts. Long or short positions in Eurodollar futures essentially constitute a position on the future movement of interest rates over a three-month period. The payoff to owning (going long) N contracts, each with a "nominal value" of $1,000,000 and acquired at a reference price P, equals

$$\text{Payoff} = (90/360) \times N \times \$1\text{ million} \times (CD - (1 - P)),$$

where CD is the calculated "average" offer rate on three-month commercial deposits of U.S. dollars in London banks at a relevant point in time. For example, assume a customer takes a long position in 200 contracts (N) at a reference price of 0.96 (P) for settlement in three months (90/360, representing the length in years of the contract). At the time of settlement, the calculated average offer rate on U.S. dollars in London is 4.4 percent annualized (CD). The customer's payoff is therefore

$$\text{Payoff} = (90/360) \times \$200\text{ million} \times (0.044 - 0.04) = \$200,000,$$

and $25 per basis point per contract. Eurodollars are designed to hedge risk for firms having pre-existing risks due to fluctuations in short term interest rates denominated in U.S. dollars.


References:

144. This is equivalent to the London Interbank Offer Rate (LIBOR) used in other interest rate products.
145. Due to financial market conventions, the proper way to interpret a reference price of 0.96 is as an interest rate of 1 minus the price, 0.04, or a 4 percent annualized rate.
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trading platforms, competing with CME’s established Eurodollar futures platform. CME had previously created a “block trading facility,” which allowed customers to trade large blocks of Eurodollar contracts without exposing them on the “floor” of the CME exchange. Block trading allows for a large numbers of contracts to be transacted at a single price without the “price slippage” that would typically occur had these contracts been traded on the floor.

On June 11, 2004, a major CME customer used the CME’s block trading facility to liquidate its position of approximately 36,000 Eurodollar contracts, moved them to LIFFE, and through pre-arrangement, replicated this position by purchases on LIFFE’s Eurodollar futures exchange. CME subsequently revised its interpretation of its wash trading Rule 432.D, and declared that further prearranged trading would be considered a “fictitious,” or a “wash trade.” LIFFE then presented a petition to the CFTC, asserting that this interpretation of CME’s rule constituted an anticompetitive restraint of trade in violation of Core Principle 18 of the 2000 CFMA.

b. Can a Manufacturer Restrict Its Rivals’ Customers from Using its Facilities?

Before we delve further into this issue, it is important that we discuss one topic. It is clear that CME is under no antitrust obligation to offer a block trading facility. Given that they do offer a block trading facility, are they now required under the antitrust laws to offer it in a non-discriminatory fashion to a rival’s customers?

This question was addressed in the D.C. Circuit en banc per curiam decision in Microsoft v. U.S. The crucial issue in Microsoft was whether Microsoft could impose restrictions on the use of its products when they were licensed to original equipment manufacturers (OEMs). The Justice Department asserted that Microsoft’s restrictions on OEM’s use of its products was anticompetitive. And Microsoft responded that its property rights under copyright laws precluded antitrust liability.

Microsoft’s argument was not well received by the D.C. Circuit. In finding the relevant restraints actionable under the antitrust laws, the court stated:

Microsoft argues that the license restrictions are legally justified because, in imposing them, Microsoft is simply “exercising its rights as the holder of valid copyrights.” Microsoft also argues that the licenses “do not unduly restrict the opportunities of Netscape to distribute Navigator in any event.”

Microsoft’s primary copyright argument borders upon the frivolous. The company claims an absolute and unfettered right to use its intellectual property as it wishes: “If intellectual property rights have been lawfully acquired,” it says, then “their

147. Wash trading is per se illegal by the Commodity Exchange Act, codified at 7 U.S.C. § 6(c) (2006). However, the definition of wash trading is not clear. Here we will abstract from the highly complex and confusing issues surround the definition of the term “wash trade.”

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subsequent exercise cannot give rise to antitrust liability” Appellant’s Opening Br. at 105. That is no more correct than the proposition that use of one’s personal property, such as a baseball bat, cannot give rise to tort liability. As the Federal Circuit succinctly stated: “Intellectual property rights do not confer a privilege to violate the antitrust laws.” In re Indep. Serv. Orgs. Antitrust Litig., 203 F.3d 1322, 1325 (Fed. Cir. 2000).

We suspect that the court’s opinion does not do justice to the nuances of Microsoft’s position. Nevertheless, the decision is clear: claims of property rights do not preclude antitrust liability. Although Microsoft was under no requirement to license its products, because it did, such licenses could not contain anticompetitive provisions. Similarly, CME was under no obligation to offer a block trading facility, but because it did, CME’s rules governing the facility cannot contain anticompetitive provisions.

c. Available Information on Market Definition

As discussed above, for a monopolization case to proceed, the moving party must show that the threat of monopoly occurs in a distinct antitrust market. This can pose a very difficult task, as can be observed in the CME/LIFFE matter.

Eurodollar futures contracts are linked to the commercial interest rate on U.S. dollar-denominated bank deposits in London. They are one of a class of contracts referred too as “short term interest rate” (“STIR”) products. STIR products serve to mitigate the interest rate risk a variety of firms have on their short-run financial obligations. Two obvious substitutes for Eurodollar contracts are: 1) Euribor futures contracts, a three month contract based on Euro interest rates instruments; and 2) the one month LIBOR contracts, which, like Eurodollars, are based on the London interbank rate. And other additional substitutes include a variety of over the counter (non-exchange traded) STIR instruments.

According to Kolb and Overdahl, there have been a substantial number of customers switching between these products over the last 20 years. In particular, customers have moved from three-month treasury futures to Eurodollar futures. And while this might imply that the two products are in the same market, the Merger Guidelines approach required customers to switch after a “small but significant” change in fees.

In a letter to the CFTC, LIFFE attempted to show market power by asserting that CME engaged in price discrimination against different classes of members. The theory behind this LIFFE assertion is that in a competitive market all customers must be offered the same price, otherwise the lower

149. Id. at 92-93 (internal citations omitted).
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p rival firm will generally take customers from the higher priced firm. CME’s pricing, however, can be seen as merely offering lower prices to those members who invested capital in CME. This way, it is perfectly consistent with competition. For example, one could imagine a private golf country club opening up its course to non-members once a week for a large greens fee, even in a competitive market for golf courses.

Another challenge for LIFFE in this proceeding was to present evidence showing that Eurodollar futures trading platforms constituted a separate antitrust market from other STIR products. In its answers to questions, LIFFE asserted that Eurodollar futures have different interest rate fluctuations, and are therefore functionally different from other STIR products. In addition, LIFFE posited that OTC instruments are not substitutes because they are not exchange traded, and therefore do not offer anonymity, price transparency, or resolve credit concerns. And while highlighting different product attributes is a good beginning to a market definition analysis, LIFFE failed to show that these differences are competitively important to the products’ customers.

Last, LIFFE presented a series of price and product changes CME made after LIFFE announced its decision to enter into a Eurodollar platform. CME made the obvious rebuttal, stating that these innovations were a part of a general industry trend toward modernization and new products. LIFFE ultimately failed to show that these actions were a direct result of the LIFFE entry, and that other firms producing STIR products did not take similar actions.

For all of these reasons, LIFFE did not meet its burden of showing that Eurodollar futures trading platforms constitute a separate antitrust market.

d. Barriers to Entry Analysis

Once the market definition analysis is complete, it is then necessary to determine whether the restraint in question constituted a “significant” barrier to entry. There are two ways we will approach this question in analyzing the CME/LIFFE matter. First, we will ask if the restraint in question significantly increases the time it would take for LIFFE to become a competitive force in Eurodollars. Second, we will examine those costs the restraint may have

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152. Id.

153. In addition, LIFFE asserted (at 12) that Eurodollars have a “high degree of price correlation to OTC instruments,” which would imply that OTC instruments might be a competitive substitute for Eurodollars. As L.M. Froeb & G.J. Wenden, Correlation, Causality, and All that Jazz: The Inherent Shortcomings of Price Tests for Antitrust Market Delineation, 8 REV. IND. ORG. 329, 329-53 (1993), show however, price correlations do not shed useful information on questions of market definition.

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imposed upon customers who desired to switch from CME to LIFFE.

(i) Time To Entry Analysis

LIFFE’s customers could avoid the CME rule by simply allowing for their positions on CME to expire before taking up new positions on LIFFE. There are, however, two potential problems with this alternative remedy.

First, it could be expensive for customers to hold positions on two different exchanges for the length of their contracts. For example, this might require two sets of monitoring clearing operations, and two sets of broker-dealer relationships. And second, it can be argued that time is an important barrier to entry here. If LIFFE customers are required to have their CME positions expire, depending on the length of the contracts of course, it would take them varied amounts of time before moving onto LIFFE.

To more closely examine this question of time, we looked at CME Eurodollar open interest on April 22, 2005 (a date chosen at random). For every three-month period we calculated what fraction of the overall CME contracts expired (See Table 2). There were approximately 8.15 million open contracts on April 22, 2005, and 1.4 million contracts, or 17.3 percent, expired within three months. Due to the effects of liquidity, competition is generally “for the market” in network economies, and 17.3 percent would not be sufficient to support new entry into the market.

If we assume that Eurodollar future exchanges are the relevant market, and that a firm must obtain a majority of the relevant market in order to succeed, then our data suggests that this wait until expiration restraint would enable the Eurodollar monopolist (as CME is posited to be) to enjoy monopoly profits for at least one year. After the passing of one year, the fraction of expired contracts rises to 60.3 percent, and after the passing of two years, the fraction of contracts rises to 83.4 percent. And while over half of the contracts would be available after one and certainly two years, it is highly unlikely that a new entrant would get 100 percent of the new contracts entered into and designed to replace existing contracts.
(ii) Cost of Exit as a Barrier to Entry

Absent the use of a block trading facility, another alternative for CME customers to switch to LIFFE is for them to trade out their positions on CME, and trade back into them on LIFFE. The question then becomes whether or not the costs of such trades are significant, relative to the cost savings a more competitive exchange might offer.

LIFFE has asserted that switching the 36,000 contracts from CME to LIFFE by trading on the CME floor would impose a cost on the relevant customer of approximately $1.1 million, or $30.55 per contract. LIFFE generated this approximate cost by calculating the average bid-ask spread that a customer has to pay to move contracts, however, we believe this figure to be an underestimate. Our review indicates that LIFFE did not account for any price slippage (especially on LIFFE).

How much could a customer save in exchange usage fees by switching to LIFFE? Perhaps not very much. LIFFE stated that, at most, a customer could save 18 cents per contract. Since the contract fees appear relatively small in comparison to contract values (perhaps 40 cents on a contract), 18 cents per contract may well have been a reasonable estimate. That said, the costs of

<table>
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<tr>
<th>Months to Settlement</th>
<th>Cumulative Contracts</th>
<th>Percent of all Contracts</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>1,409,281</td>
<td>17.3%</td>
</tr>
<tr>
<td>6</td>
<td>2,796,916</td>
<td>34.3%</td>
</tr>
<tr>
<td>9</td>
<td>4,044,894</td>
<td>49.6%</td>
</tr>
<tr>
<td>12</td>
<td>4,918,277</td>
<td>60.3%</td>
</tr>
<tr>
<td>15</td>
<td>5,584,939</td>
<td>68.5%</td>
</tr>
<tr>
<td>18</td>
<td>6,059,146</td>
<td>74.3%</td>
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<tr>
<td>21</td>
<td>6,519,868</td>
<td>79.9%</td>
</tr>
<tr>
<td>24</td>
<td>6,805,676</td>
<td>83.4%</td>
</tr>
<tr>
<td>27</td>
<td>7,030,697</td>
<td>86.2%</td>
</tr>
<tr>
<td>30</td>
<td>7,205,636</td>
<td>88.3%</td>
</tr>
</tbody>
</table>

155. Id.
156. For a discussion of price slippage (or “market impacts”) see HARRIS, supra note 12, at 72-73, and the discussion above.
158. Also, the figures LIFFE presented to the CFTC were made available to CME and CME was
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switching contracts would be far greater than the savings on those contracts, and thus is considered a significant barrier to entry.159

e. CME/LIFFE Conclusion and the Difficulty with the Trinko Dicta in the Commodity Exchange Arena

With little or no response to their complaint, LIFFE’s was left with no choice but to close its Eurodollar trading facility. After receiving LIFFE’s complaint, the CFTC did very little. It issued no subpoenas, and there is no evidence it conducted interviews with interested parties. And while it issued requests for the two parties to submit letters to it, it issued no opinion on the matter.

On August 31, 2005, seventeen months after it filed its complaint, LIFFE announced it was closing its Eurodollar trading facility. After CME issued its new interpretation of its wash trading rule, and after the inaction by the CFTC, LIFFE was not able to wrestle any significant Eurodollar open interest or volume from CME.160

Although the Supreme Court’s recent decision in Trinko did not make any new law in the implied immunity doctrine, it did produce some dangerous dicta concerning when courts should and should not take on a cases involving both antitrust issues and a regulatory authority. In Trinko, the Court noted that where there is a detailed regulatory scheme, it is incumbent on courts to consider whether “the regulated entities are not shielded from antitrust scrutiny altogether by the doctrine of implied immunity,” and that it is important for courts “to avoid the real possibility of judgments conflicting with the agency’s regulatory scheme.”161

For whatever reason, LIFFE decided to pursue its complaint with the CME’s rule interpretation before the CFTC rather than pursuing the matter in court. Had LIFFE taken the matter up in court, the CME would have certainly argued, inter alia, that under Trinko and the other implied immunity cases, the matter should have been dismissed, and instead heard before the CFTC.

Our belief is that, had LIFFE pursued this matter in court the court route, CME’s Trinko argument would have failed. As the law and regulations governing commodity exchanges have changed significantly since the passage of the 2000 CFMA, it has become more difficult to successfully argue that a “pervasive regulatory scheme” effectively granting CME a “get out of jail free”

given the opportunity to respond to them. Because CME chose not to respond, it may be appropriate to accept LIFFE’s position on this issue.

159. Note, however, that LIFFE did not present to the CFTC the cost of using the block trading facility to move the 36,000 contracts.

160. In fairness to the CFTC, however, LIFFE never asked for any specific relief. It merely asked the CFTC to look into the matter.

card (implied immunity) is in place.

The 2000 CFMA was revolutionary in that it effectively shifted the power of regulation from the CFTC to the exchanges it regulates. That is, the CFMA went from a prescriptive regulatory regime to a "Core Principles" approach. Now, once an exchange is granted an exchange license and "Designated Contract Market" status, it is then able to "self-certify" almost anything it wants with respect to its own rules and operating procedures.\(^{162}\) The CME took advantage of its self-regulation duties when it "self-certified" its wash trading rule interpretation, and simply informed the CFTC of such.

The regulator and the regulatory scheme did not dictate any result in the matter. As a result, the CFTC apparently was not certain how to respond to the complaint from LIFFE, and so it did nothing. Because this matter went unresolved and the status quo prevailed, the CME won the battle whereas the LIFFE Eurodollar contract busted.

The CFTC has done very little, if anything, in response to exchange self-certifications since the passage of the CFMA. Indeed, to the best of our knowledge, the CFTC has not done anything to stop an exchange self-certification since the CFMA amended the CEA in 2000. And while it is not surprising that the CFTC did not do anything in the LIFFE-CME matter, there were, nonetheless, steps the CFTC at least theoretically could have taken.

The mildest CFTC action would have been to have simply asked CME to demonstrate its continuing compliance with the CEA, whereas the most punitive measure would have been to initiate a criminal proceeding, via referral to the Justice Department. The range of responses is listed below in the order that they appear in the Act, not in the order of severity.

Section 5c(c) of the CEA provides a brief background on the self-certification process. Exchanges "may elect...to approve and implement any new rule or rule amendment, by providing to the Commission...a written certification that the new contract or instrument...complies with this Act."

Section 5(d)(18) of the CEA provides that, "Unless necessary or appropriate to achieve the purposes of the Act, [contract markets are required] to endeavor to avoid—adopting any rule or taking any actions that result in any unreasonable restraints of trade or imposing any material anticompetitive burden on trading on the contract market."

Generally, if an exchange submits a false certification, there are a number of possible remedies available under the Act and rules. Under section 5c(d) the Commission may determine whether a registered entity is violating any applicable core principle. If the CFTC finds that the entity is violating a core principle, it shall notify the registered entity of its determination and afford the

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\(^{162}\) Exchanges, at their own discretion, still have the ability to seek Commission approval of their rules or procedures under the Act. See 7 U.S.C. § 7(a)(2) (2006).
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registered entity an opportunity to make appropriate changes to bring the registered entity into compliance. If the registered entity does not do so, then the Commission may take such further action in accordance with the act.

Under the Act, the following further remedies would be available:

1. Under 6b, the Commission may bring an administrative action (including fines and cease and desist orders) if any registered entity is violating or has violated any of the provisions of the Act. Accordingly, the Commission may bring an administrative action for a false certification.

2. Under 6c, the Commission can seek an injunction or ask for a temporary restraining order whenever it appears to the Commission that a registered entity is either violating or is about to act in a practice constituting a violation.

3. Under 5e, the failure of a registered entity to comply with any provision of the Act, shall be cause for the suspension of the registered entity, or to have its designation revoked.

4. Under 8a(7), the Commission is empowered to "alter or supplement the rules of a registered entity insofar as necessary or appropriate . . . for the protection of persons producing, handling processing or consuming any commodity traded for future delivery, or for the protection of traders." Section 8a(7) sets forth a specific procedure that must be followed, but it is basically notice and comment rulemaking, with some additional requirements.

5. Under 9(a), it is a felony to "knowingly make any statement in any application report or document required to be filed which was false or misleading with respect to a material fact." Because this is a criminal provision, it requires proving scienter so it would be more difficult to apply. Nevertheless, this is an available remedy, if referred to the Justice Department and if the facts warranted.

6. As a separate matter, under Part 38 and the Act, the Designation Application requirements apply initially and on a continuing basis thereafter. Accordingly, the Commission at any time can ask an exchange under rule 38.5(b) to demonstrate that the contract market is in compliance with one or more core principles.

7. Again, as a separate matter, under 15(b), the Commission itself is required to take into consideration the public interest to be protected by the antitrust laws . . . in issuing any order or adopt . . . or requiring or approving any bylaw, rule or regulation of a contract market."

Despite these remedies under the CEA, we were unable to find any action in which the CFTC utilized any of its authority in response to anticompetitive actions by an exchange. Thus, established exchanges may conceivably have unchecked opportunity to engage in virtually any desired anticompetitive activity. The CEA, as amended by the CFMA, has had the effect of helping incumbents maintain their monopolies. As demonstrated by CME and their wash trading rule interpretation, established exchanges are allowed to create rules (or, for example, incentive programs for traders) that benefit and support their monopolies without repercussion.

Accordingly, we would recommend that courts faced with an antitrust complaint against a commodity exchange take a close look at the ability of the CFTC to take action (and its history in taking action, or rather, inaction) before liberally interpreting the dicta in *Trinko*. When courts defer to a regulatory
agency, antitrust defendants are able to hide behind the doctrine of implied immunity while knowing full well that they may be violating antitrust laws, and antitrust plaintiffs are often left without a remedy. As a result, the ultimate goal of antitrust law, providing the efficiency of the markets, is not served.

B. Predation Cases

1. Theory

The basic predatory pricing theory is simple. To combat entry, an incumbent firm lowers its price below its marginal costs. It continues this practice until it drives its rival out of business. Once its rival has exited, the incumbent raises its prices to the pre-entry level. And while predatory pricing is a very old story in antitrust, proving a predation case can be remarkably difficult.

Predation as a strategy has a certain intuitive appeal, but any hypothesized predator must first face several difficult realities. By lowering its own prices, a predator also lowers the revenues and profits on its pre-predation volume. Lower prices also increase consumer demand, and because selling below cost is a usual precondition for predation, this increased demand typically increases the predator’s losses. In addition, lower prices will also cause the intended victim to reduce its output, thereby increasing demand (and therefore losses) for the predator’s product. Together, these three elements imply that the predator’s losses through a predatory strategy are likely to be far in excess of the victim’s losses.

The predator may also face an additional barrier to enter or exit problem. The fewer barriers to exit there are, the easier it will be for the predator to induce the victim to leave the market. Exit barriers are usually considered to be “sunk costs,” costs of investment that cannot be recouped upon exit. But for predation to be profitable, the predator must be able to make supra-competitive profits after the predatory period is over. This, in turn, implies significant barriers to entry will prevent new firms from entering as a response to the post-predation high prices. Notably, barriers to entry are also generally thought of as sunk costs; barriers to exit are thus barriers to exit as well.

For example, assume that an independent entrepreneur with only limited financial resources decides to enter into the operation of a gasoline station. That entrepreneur is able to overcome the relevant barriers to entry, dealing with obtaining an appropriate site, an environmental permit for the site, and an environmentally appropriate storage tank for the gasoline. Now assume that

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once that operator enters business, it becomes the target of a predatory strategy by a larger firm. Such a predatory strategy may well drive this operator out of business, but that does not mean that this strategy is profitable for the predator.

The difficulty in the predation strategy arises because causing a particular operator to stop operating a particular station is not the same as preventing that station from operating. Even if a particular operator has left the business, the assets of the station are likely to still exist, and may well be owned by the creditor of the operator. Once the predator raises price to capture its profits, the creditor has important incentives to sell the property to another, perhaps better financed entity, and to have the property reenter operation as a gasoline station.

In summary, the theory of predatory pricing implies is that a successful predator desires an industry with significant barriers to entry, but insignificant barriers to exit. Such a situation occurs only rarely, but applies more readily to commodity exchanges. As discussed above, the most useful way for an entrant exchange to gain customers is to pay them to use that exchange. This represents one sunk cost that cannot be recouped should the new firm be forced to exit. In addition, a necessary condition for predation is market power in an appropriately defined antitrust market. A prerequisite for market power is a high market share,164 and if one commodity constitutes an antitrust market, then this criterion is likely to be met.

In order for a court to find predation, the relevant legal test requires that the prices charged must be below marginal cost.165 This may be a difficult test to meet in commodity exchanges, where much of the cost is up-front, and only a small amount of cost is incurred per trade.

In such circumstances, courts have been reluctant to support cases of predation. For example, in the prominent case United States v. AMR Corp.,166 the Department of Justice alleged that American Airlines engaged in predatory pricing with respect to a variety of airline routes in and out of Dallas-Forth Worth. For the purposes of predatory pricing, the airline industry is much like the commodity exchange industry, with high fixed costs and low marginal costs.

The Justice Department argued that in determining marginal costs, "incremental" costs for flying a particular route should be included. The District Court rejected this argument as contrary to a large number of precedents with respect to measurement of costs.

The Justice Department also contended that American Airlines was trying

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165. Brooke Group, Ltd., 509 U.S. at 222-23. Average variable cost is often used as a proxy for marginal cost, where average variable cost equals (total costs − fixed costs) divided by quantity produced.
to create a "reputation" for predation. In theory, if there is a dominant firm that "enjoys" predation rather than profit maximizing, a predation "pooling equilibrium" may exist when profit-maximizing firms mimic the dominant "irrational" firm. In effect, the profit-maximizing firm "pretends" to be irrational and is thereby able to deter entry into its market.\textsuperscript{167}

The District Court rejected this theory as largely speculative, stating:

The problem with all such strategies is not that we doubt their existence or even their anticompetitive consequences. Rather, identifying them in the particular case without chilling aggressive, competitive pricing is far beyond the capacity of any antitrust tribunal. Once we cross the threshold and permit prices above cost to be condemned as predatory, we throw the doors open to all kinds of speculation about the pricing strategies of large firms—speculation that judges ordinarily address by opening discovery, including evidence of presumed anticompetitive intent, and making a jury the final decision-maker. \textit{Antitrust begins with the premise that all firms, even dominant firms, are permitted to compete aggressively, and that hard competition is a desideratum rather than an evil. Thus prices above the relevant measure of cost become an absolute safe harbor.}\textsuperscript{168}

\textbf{2. Application III: USFE v. CBOT/CME}

USFE sued CBOT and CME for \textit{inter alia}, predation in addition to its vertical theory. USFE asserted that immediately prior and during USFE's entry into the treasury market, CBOT engaged in predatory pricing. In particular, USFE asserted that CBOT lowered its average trading charges on Treasury futures (execution fees) from $0.376 to $0.086, or slightly over 77 percent. (See Table 3.)

\footnotesize
\begin{itemize}
  \item \textsuperscript{168} \textit{AMR Corp.}, 140 F. Supp. 2d 1141 (emphasis in original).
\end{itemize}

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Table 3

CBOT Changes in Treasury Futures Trading Charges Per Contract

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Trades ≤ 25,000/month</td>
<td>Trades ≥ 25,000/month</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Member’s Account with Member Trading</td>
<td>$0.12</td>
<td>$0.10</td>
<td>$0.05</td>
<td>$0.00</td>
<td>$0.00</td>
</tr>
<tr>
<td>Member’s Account with Non-Member Trading</td>
<td>$0.274</td>
<td>$0.30</td>
<td>$0.20</td>
<td>$0.06</td>
<td>$0.06</td>
</tr>
<tr>
<td>Non-Member’s Account</td>
<td>$1.054</td>
<td>$0.90</td>
<td>$0.075</td>
<td>$0.30</td>
<td>$0.30</td>
</tr>
<tr>
<td>Non-Member Leasing CBOT Seat</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>$0.06</td>
<td></td>
</tr>
</tbody>
</table>

Of course, this information, by itself, is not sufficient to show predatory pricing. The next relevant piece of information is the marginal cost to the exchange of trading. It may well be that this cost is very low, in that exchanges could be like airlines, and the marginal cost of providing the service is small when compared to the capital cost. If low marginal costs is the case, then American Airlines might hint that winning a predatory pricing case in the commodity exchange industry could be quite difficult.

Even so, there are some distinct and notable facts in USFE v. CBOT/CME. The following chronology details USFE’s allegations:

-- On February 3, 2004, knowing that USFE would be approved within days, CBOT announced new preemptive cuts in its electronic transaction fees for U.S. Treasury futures and options, retroactive to February 1, 2004. Notably, the CBOT did not introduce similar price cuts in its non-electronic trading services for these products, which

Eurex U.S. did not offer.

-- On February 12, 2004, after USFE had been available as a competitive alternative to CBOT’s monopoly for one week (and Eurex US had decent numbers in its treasury market in terms of percentage of trades), CBOT announced a further price cut.

-- At the time of these price cuts, the Chairman of CBOT, Charles Carey, wrote a letter to the members of CBOT informing them that the price cut would be reviewed in 6 months and was likely temporary.170

-- USFE had some success with the treasury product during the late summer/early fall of 2004 due, in large part, to an aggressive incentive program dubbed the “Liquidity Initiative.” As the heart of the USFE Liquidity Initiative was expiring in December 2004 and USFE was beginning to lose market share, CBOT announced a price increase in its Treasury products.

-- By June 2005, USFE’s market share in the Treasury products was less than 1 percent on a daily basis. As such, USFE declared the war for the Treasuries over and indicated that it would no longer support the product, but it would keep it listed. Approximately two months later, CBOT announced a significant price increase in its Treasury products.171

While these factors seem to imply predatory intent on the part of CBOT, CBOT could argue that it was simply reacting to the emergence, and later the ending of new competition. In addition, despite the fact that CBOT was charging execution fees of $0 to a significant percent of the market at the time USFE was attempting to initially compete in the market, it was not charging below costs. Last, CBOT will likely argue that there are product substitutes for Treasury futures, such as the over-the-counter market or unregulated derivative market.

Proving predation under the antitrust laws, even in an apparently fairly clear-cut case, is a difficult proposition. In any event, if USFE v. CBOT/CME proceeds to summary judgment and/or a trial, it will certainly provide interesting, and perhaps groundbreaking insights into the law of predation.


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C. Essential Facility or “Duty to Deal” Cases

1. Theory

In a broken and arguably inconsistent line of cases dating back to *Terminal Railroad* in 1912, the Supreme Court and lower courts have asserted that firms with market power may have a duty to deal with their fledgling competitors, allowing such competitors to use their rivals’ “essential facilities.” These are, however, cases that have been subject to a large degree of criticism in the academic literature.

The basic economic theory behind the essential facilities doctrine is that the relevant firm is “leveraging” its monopoly from one market into another vertically related market. But critics note, leveraging is not a recognized concept in economics. Economic theory points out that in the vertical chain for a product there exists one, and only one, monopoly profit. A firm can gain that profit by monopolizing any part of the production chain. Thus, if a firm has market power in one stage of production, it cannot increase that power by gaining a monopoly at another stage of production.

The most important recent essential facilities case is *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.* In this matter, the Aspen Skiing Company (“Aspen Ski”) controlled three of the four skiing mountains in Aspen, Colorado, and the fourth was controlled by the Aspen Highland Skiing Corporation (“Aspen Highland”). The two relevant firms entered into an agreement for a joint ski ticket, but after the initial agreement lapsed, Aspen Ski refused various entreaties from Aspen Highland to extend the agreement. Aspen Highland sued Aspen Ski on antitrust grounds, and the Supreme Court found for the plaintiff. Because the joint ski ticket reduced transaction costs for skiing consumers, it was considered in the consumers’ interest and the Supreme Court ordered it to continue.

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173. Lower courts and commentators often call this the “essential facilities doctrine,” though the Supreme Court has repeatedly eschewed such a direct formulation.
174. Criticism of leveraging generally extends to the essential facilities doctrine because “the rationale of the essential facility doctrine is exactly the same as that of the leveraging cases.” Gregory J. Werden, *The Law and Economics of the Essential Facility Doctrine*, 32 ST. LOUIS U. L. J. 433, 460 (1987); David Reiffen & Andrew N. Kleit, *Terminal Railroad Revisited: Foreclosure of an Essential Facility or Simple Horizontal Monopoly?*, 33 J.L. & ECON. 419, 420-21 (1990) (“[E]conomic theory suggests[s] that there is no need for an essential facilities doctrine, as firms do not have anticompetitive reasons to deny access.”); PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 174 (1996) (“[C]onsumers are no better off when a monopoly is shared; ordinarily, price and output are the same as they were when one monopolist used the input alone.”); Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic, 65 F.3d 1406, 1413 (7th Cir. 1995).
There are many critiques one can make of Aspen Ski.\textsuperscript{176} For example, a rule that requires firms to extend agreements they have made with their rivals discourages such agreements from being entered into in the first place. In addition, it is not clear how courts should generally set remedies in such cases.\textsuperscript{177} Perhaps continuing the agreement in Aspen Ski made sense, at least for some time. But in a dynamic economy, how can or should a court regulate an economic agreement between firms? Antitrust courts are not regulators, nor do they generally set prices or conditions.\textsuperscript{178}

Perhaps in response to this criticism, the Supreme Court reduced the legal scope of the duty to deal in the 2004 case, \textit{Trinko}. In \textit{Trinko}, the Court indicated that the essential facilities doctrine could not be used to require a duty to deal if either: 1) there had not been a prior contract between the parties on the relevant point (in contrast to the fact situation in Aspen Ski), or 2) there was a regulatory agency that could, as part of its regulatory mission, require and directly regulate such a relationship.

2. \textit{Application IV: ICE v. NYMEX}

A host of issues were raised in the recently decided ICE v. NYMEX case. NYMEX operated the only commodity exchanges in natural gas (based on Henry Hub, Louisiana) and oil (West Texas Intermediate, based on Cushing, Oklahoma). ICE attempted, in various ways, to compete with NYMEX in these products. After its initial attempts in this market, ICE decided it needed to offer its customers clearing services, and especially “marking to market” services, to become competitive.

Marking to market requires final closing prices, and that was the major bone of contention in the ICE/NYMEX matter. ICE originally offered an “over-the-counter” trading platform in oil and natural gas. On this platform, parties “met” and traded products, but clearing and delivery issues were left to the contracting parties. ICE decided to expand its operations by providing clearing services for the contracting parties.

For clearinghouse services to be the efficient, the most accurate end of day prices are required. ICE could have used its own prices, but, as the upstart exchange, ICE had less trading, a less liquid exchange, and therefore less accurate closing prices. ICE desired to use NYMEX’s closing price for its settlement purposes, and NYMEX refused. The history of property rights law generally provides that prices belong to the exchanges that generate them, and


\textsuperscript{178} Another difficulty with \textit{Aspen Skiing} is the market definition, which was the self-contradictory “[d]ownhill skiing at destination ski resorts” in Aspen. 472 U.S. at 595 n.20 (citation omitted).
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thus, under basic contract law, NYMEX could deny ICE access to these prices.

ICE’s plea for relief was a combination of essential facilities and vertical restraint theories. ICE asserted that NYMEX’s prices were “essential” to the operation of its rival trading platform. NYMEX, by itself, would do nothing to create competition in the relevant market. ICE, asserted that allowing it access to NYMEX’s prices would strengthen its own exchange, so as to increase in volume and develop higher quality closing prices. Last, this would in turn eliminate ICE’s need to use NYMEX’s prices.

In a summary judgment ruling, the District Court focused on ICE’s essential facilities claim. Citing Trinko in its first argument, the court noted that an essential facilities claim should be denied when a “federal agency has effective power to compel sharing and regulate its scope and term.” The court then asserted that the CFTC had this power; however, this conclusion has given rise to some confusion.

In its core principles, the CFTC has the right to compel exchanges to release information without charge to the public. But this compulsion has two important limitations. First, exchanges are not required to release information in a timely manner. Thus, many exchanges will sell a premium information service that provides “real time” information, while releasing twenty-minute old information for free. Second, exchanges can limit the use of their commercial information sold to third parties. Thus, it is not certain that the CFTC has the ability to force the sale of time-sensitive information for use by third parties.

The CFTC’s core principles also require it to evaluate antitrust issues in commodity exchanges. But even together with its principles on releasing information, it is far from clear whether the CFTC could compel the release of information at issue in ICE/NYMEX. And even if the CFTC had the authority to do so, it remains unclear what rates the CFTC would or should impose on the transaction. The CFTC has never imposed a rate regulation on any product, and it is unclear how it would do so. As with most information products, the marginal cost of supplying information to outside parties is close to zero. The costs associated with providing information are largely in up-front capital expenses and in the risk of product failure.

The court was on firmer ground in its second argument. The essential facilities test in ICE/NYMEX is essentially that a prior contractual relationship is a sign of an economically efficient relationship. Unlike Aspen, ICE was not seeking to renew a previous sharing agreement with NYMEX, and therefore its claim was flawed. In addition, the court also noted that NYMEX has an efficiency reason not to deal with ICE: to prevent ICE from free-riding on its price-generating operations.
VII. CONCLUSION

The rise of competition in commodity exchanges also brings with it antitrust enforcement. Where this enforcement will take place, however, is unclear. Courts will be challenged to articulate a logical theory of antitrust immunity that allows administrative agencies to carry out their regulatory missions while still allowing parties their day in court.

As shown in recent cases, antitrust principles can be applied to antitrust disputes between and among commodity exchanges. While regulatory agencies may wish to set their own policies, there is no obvious need for such an event. Indeed, as the CME/LIFFE matter shows, regulatory agencies may not be in a position to grant aggrieved firms effective relief, and courts should be reluctant to grant parties antitrust immunity.